Select Committee on Pension Policy

P.O. Box 40914 Olympia, WA 98504-0914 actuary_st@leg.wa.gov

July 13, 2004

10:00 AM - 1:00 PM

Senate Hearing Room 4
Olympia, Washington

AGENDA

10 AM (1) Election of Chair

10:15 AM (2) Adoption of Interim Meeting Schedule

10:30 AM (3) Purchasing Power

Bob Baker, Senior Research Analyst

11:15 AM (4) Post-retirement Employment

- Laura Harper, Senior Research Analyst Legal

Noon (5) Contribution Rate-setting

Matt Smith, State Actuary

1:00 PM **(6) Adjourn**

Persons with disabilities needing auxiliary aids or services for purposes of attending or participating in Select Committee on Pension Policy meetings should call (360) 753-9144. TDD 1-800-635-9993

Representative Gary Alexander

Elaine M. Banks TRS Retirees

Marty Brown, Director*
Office of Financial Management

Senator Don Carlson

John Charles, Director Department of Retirement Systems

Representative Steve Conway®

Vic e Chair

Richard Ford PERS Retirees

Senator Karen Fraser

Representative Bill Fromhold

Leland A. Goeke*

TRS and SERS Employers

Bob Keller

PERS Actives

Corky Mattingly

PERS Employers

Doug Miller

PERS Employers

Glenn Olson

PERS Employers

Representative Larry Crouse

Diane Rae

TRS Actives

Senator Debbie Regala

J. Pat Thompson

PERS Actives

David Westberg*

SERS Actives

Senator Shirley Winsley*

Chair

***Executive Committee**

(360) 753-9144 Fax: (360) 586-8135 TDD: 1-800-635-9993

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DRAFT MINUTES

June 15, 2004

The Select Committee on Pension Policy met in Senate Hearing Room 4, Olympia, Washington on June 15, 2004.

Committee members attending:

Representative Alexander Elaine Banks Representative Conway, Vice-Chair Representative Crouse Richard Ford

Senator Fraser Representative Fromhold Robert Keller Glenn Olson Senator Regala J. Pat Thompson David Westberg

Senator Winsley, Chair

Senator Winsley, Chair, called the meeting to order at 10:20 AM.

(1) Adequacy of Benefit

Bob Baker, Senior Research Analyst, and Laura Harper, Senior Research Analyst Legal, reviewed the report entitled "Adequacy of Retirement Benefit."

The following person testified:

Leslie Main - Washington State School Retirees' Association

(2) Military Service Credit

Laura Harper, Senior Research Analyst Legal, reviewed the report entitled "Military Service Credit."

The following person testified:

John Kuamme, Washington Association of School Administrators/ Association of Washington School Principals

(3) Announcements

Senator Winsley stated the next SCPP meetings would be July 13th and August 17th.

Senator Winsley announced she was retiring from the State Legislature and that this would be her last SCPP meeting. Members of the Committee thanked her for her many years of service and wished her well in her new Board position.

The meeting adjourned at 12:45 PM.

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Senator Shirley Winsley* Chair

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SELECT COMMITTEE ON PENSION POLICY

Proposed Meeting Schedule

(July 8, 2004)

April 20, 2004

10 AM - 12:30 PM, Senate Hearing Room 4

Election of Officers Session Update Interim Work Plan Meeting Dates

May 18, 2004

9:30 AM - 4 PM, Senate Conf. Room A-B-C

Orientation:

Summary of States' Pension Issues & Federal Legislation Emerging Issues in Washington Member Priorities for Washington Pensions

Committee Goals and Challenges

Orientation Manual

June 15, 2004

10 AM - 12:30 PM, Senate Hearing Room 4

Adequacy of Benefit Military Service Credit

July 13, 2004

10 AM - 1 PM, Senate Hearing Room 4

Election of Chair Purchasing Power Post-retirement Employment Contribution Rate Setting August 17, 2004

10 AM - 1 PM, Senate Hearing Room 4

September 7, 2004

October 19, 2004

November 9, 2004

Legislation:
Plan 3 Vesting
Part-time ESAs

December 7, 2004

Legislation

SCPP Meeting Dates		
Date Yes No		
July 13	Keller, Miller, Banks, Westberg, Fromhold, Regala, Mattingly, Olson, Ford, Conway, Brown, Carlson, Crouse, Fraser, Rae, Charles, Goeke	Alexander
August 10	Keller, Miller, Fraser, Banks, Goeke, Regala, Olson, Brown, Carlson, Crouse, Rae	Alexander, Charles, Westberg, Fromhold, Mattingly, Ford, Conway
August 17	Alexander, Charles, Keller, Fromhold, Goeke, Regala, Mattingly, Ford, Conway, Brown, Carlson (prefers 8/10), Crouse, Rae	Miller, Fraser, Westberg, Olson
September 7	Alexander, Keller, Miller, Fraser, Banks, Westberg, Fromhold, Goeke, Regala, Mattingly, Ford, Conway, Carlson (maybe), Crouse,	Charles, Brown, Olson, Rae
October 12	Keller, Miller, Banks, Westberg, Fromhold, Goeke, Regala, Olson, Ford, Conway, Carlson, Crouse, Rae	Alexander, Charles, Brown, Fraser, Mattingly
October 19	Alexander, Charles, Keller, Fraser, Westberg, Fromhold, Regala, Mattingly, Olson, Ford, Conway, Brown, Carlson, Crouse, Goeke, Rae	Miller
November 9	Alexander, Charles, Keller, Miller, Fraser, Banks, Goeke Westberg, Fromhold, Regala, Mattingly, Olson, Conway, Brown, Crouse, Rae	Ford, Carlson
December 7	Alexander, Charles, Keller, Miller, Fraser, Banks, Westberg, Fromhold, Goeke, Mattingly, Ford, Carlson, Crouse, Rae	Brown, Olson, Conway

O:\SCPP\2004\7-13-04 Full\SCPP Meeting Dates.wpd revised 7/1/04

Select Committee on Pension Policy

Purchasing Power

(July 6, 2004)

Issue

Purchasing power in relation to retirement is the measure of how a benefit retains its value over time. The concern among retirees is that because of inflation, their benefits may be losing purchasing power, particularly for those who have been retired for extended periods. The Select Committee on Pension Policy considered Purchasing Power to be among their four top priority issues to discuss during this interim.

Staff

Robert Wm. Baker, Senior Research Analyst 360-586-9237

Members Impacted

This issue primarily impacts Public Employees' Retirement System plan 1 (PERS 1) and Teachers' Retirement System plan 1 (TRS 1) members. As of the most recent valuation, there were 21,737 active and 54,006 retired PES 1 members, and 12,456 active and 33,148 retired TRS 1 members.

Current Situation

Currently, the purchasing power of PERS 1 and TRS 1 benefits is partially protected by the Uniform Increase they receive on July 1st of each year after one year of retirement and after age 66. The Uniform increase is a dollar amount multiplied by the members' total years of service; that product is added to a member's monthly benefit each year. As of July 1, 2004, the Uniform Increase Amount was \$1.21; a retiree who was at least age 66 with 30 years of service will be receiving a monthly increase of \$36.30.

The Uniform Increase Amount increases each year by at least 3%. When gain-sharing is available, distributions are made by enhancing the Uniform Increase amount and thus the Uniform COLA.

Also available to PERS 1 and TRS 1 members is the COLA payment option. Upon retirement, members may choose to take an actuarially adjusted benefit that increases each year with inflation to a maximum of 3% per year —similar to the Plan 2 COLA. This option became available in 1990, and gives members greater financial stability during retirement.

History

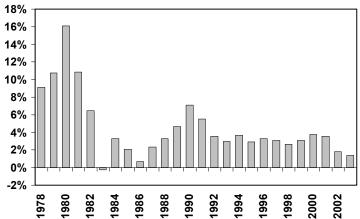
The PERS 1 and TRS 1 plans have experienced numerous legislative efforts to provide some level of purchasing power protection. The history of those efforts can be found in Appendix A of this report. These efforts began in 1961 with the establishment of a \$900/year minimum pension for those who retired at age 70 with at least 10 years of service. The most recent efforts lead to the \$1,000/ month Minimum Benefit legislation passed this year.

Less successful efforts to bolster TRS 1 and PERS 1 retiree's purchasing power have included bills seeking to increase the frequency of gain-sharing or lower the investment return threshold for determining when gain-sharing distributions occur. Gain-sharing, established in 1998, occurs on even-numbered years when the compounded rate of return on the TRS and PERS plan assets exceeds 10% over the most recent 4-year period. One-half of the amount in excess of 10% is distributed to TRS 1 and PERS 1 retirees via the Uniform COLA and to Plan 3 member's through their defined contribution accounts.

The legislative history of efforts to shore-up TRS 1 and PERS 1 retiree's purchasing power is a history of inflation; inflation being the reason retirement benefits lose purchasing power in the first place. Inflation is treated as a constant in the plan designs and within the actuarial valuations, which is appropriate considering the long-term character of retirement systems. For

individuals, however, inflation is a variable that can change from year to year (see Figure 1). In the past 25 years, local changes in consumer prices have been as high as 16.1% and as low as -0.3%.

Figure 1
Annual Percent Changes
Seattle CPI-W: 1978-2003



Because of the variability of inflation, for those retirees whose benefit is not protected by a COLA, *when* they retire has a bearing on how their benefit retains its purchasing power. A worker who retired in 1977 would have seen their benefit lose almost 40% in value in the first five years of retirement (see Figure 2).

Figure 2

Purchasing Power Loss In the First 5 Years of Retirement



Examples

Purchasing power is measured by comparing the change in member's benefits over time with the amount of inflation over the same period. In these examples, the Consumer Price Index for Wage Earners and Clerical Workers (CPI-W) for the Seattle-Tacoma-Bremerton region has been used for the inflation measure. Also used in this calculation are benefits members originally received upon retirement and benefits they currently receive (see Figure 3).

Figure 3 Purchasing Power Calculation

(Current Benefit / Original Benefit) × (Original CPI-W / Current CPI-W)

Current Benefit: \$1,164 Original Benefit: \$1,002 Original CPI-W: 369.0 Current CPI-W: 553.6

 $(\$1,164 / \$1,002) \times (369.0 / 553.6)$

116.2% × 66.7% = 77.43%

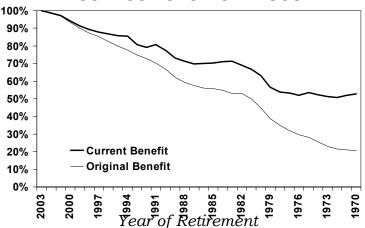
The above illustration uses the average benefit data from PERS 1 members who retired in 1990. By 2003, their average benefits had increased 16.2%. Inflation over the same period, as measured by the CPI-W, had increased by 50%. To determine the benefit's purchasing power, they must be deflated by a factor of .667. As a result, the current benefits have retained 77.4% of their original purchasing power.

This method was used to measure the purchasing power for all PERS and TRS members who retired from 1970 onward.

Plan 1 Examples

Figure 4 (following page) demonstrates the experience of PERS 1 members who have retired since 1970. The gap between the Original Benefit line and the Current Benefit line represents the COLAs that members have received.

Figure 4
Purchasing Power of PERS 1
Service Benefits in 2003

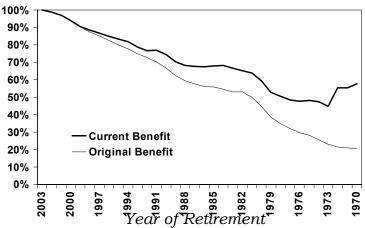


The varying slopes of the lines represent the changes in inflation with the steepest slopes being the periods of highest inflation. What this example illustrates is the relatively short time it takes for a PERS 1 benefit to lose a significant amount of value. Those who retired in 1999 have already lost 10% of their original benefit's purchasing power. At the most extreme point on this graph member benefits have experienced a loss of almost 50% of their original purchasing power.

Also evident in this graph is the potential loss of purchasing power if there had been no COLAs whatsoever. Had a member retired in 1970 and received no benefit improvements, their 2003 benefit would be worth but 20% of its original purchasing power.

The TRS 1 illustration (see Figure 5) is similar except for some obvious bump-up of benefits for those retired the longest. Early legislation that sought to improve retiree benefits tended to be system specific; TRS retirees benefitted from these COLAs. In addition, those retirees whose retirement allowance had lost the most are those who receive the greatest improvement from the current Uniform increases, this was particularly evident for those TRS 1 members who retired in 1970-1972 under the 1% plus annuity formula.

Figure 5
Purchasing Power of TRS 1
Service Benefits in 2003



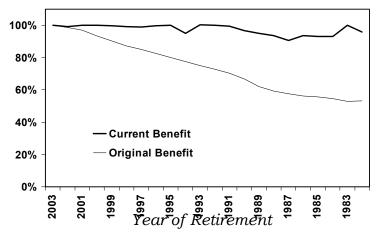
Because TRS members retire an average of 1.5 years younger than PERS members (58.5 years compared to 60 years), the decline in purchasing power is a bit more pronounced early in their retirement because they must wait longer to receive the Uniform COLA. Similar to PERS retirees though, those retired the longest have experienced a loss of about half their original purchasing power.

Plan 2/3 Examples

Purchasing power trends in the plans 2/3 offer a telling contrast to PERS 1 and TRS 1. Retired plan 2/3 members receive a CPI-based COLA beginning one year after retirement (the plan 3 COLA covers the defined benefit). In addition, plan 2/3 members receive the COLA even when they opt for early retirement.

A similar COLA is a payment option for PERS 1 and TRS 1 retirees. By taking the COLA payment option, members accept an actuarially reduced initial benefit in order to receive CPI-based COLAs (to a maximum of 3% per year.) This provides plan 1 members a more stable benefit stream.

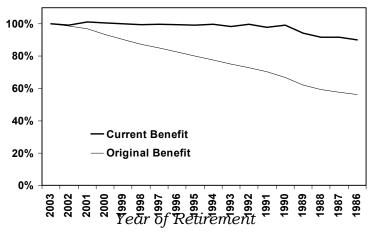
Figure 6
Purchasing Power of PERS 2/3
Service Benefits in 2003



PERS 2/3 purchasing power patterns are distinctive in their stability. Even after twenty-one years of retirement, member's benefits lost only 5% of their original purchasing power (see Figure 6). And that loss may not be permanent; COLA design in the plans 2/3 allows benefits to "catch-up" during low-inflation years. In comparison, after twenty-one years, PERS 1 member's benefits had lost 31% of their original purchasing power.

TRS 2/3 purchasing power patterns differ from those of PERS 2/3 only in that the first TRS 2 retirements were in 1986 while the first PERS 2 retirements were in 1982.

Figure 7
Purchasing Power of TRS 2/3
Service Benefits in 2003



TRS 2/3 benefits have retained their purchasing power similar to those of PERS 2/3. After seventeen years of retirement the average TRS 2/3 benefit retained 90% of its purchasing power (see Figure 7). This is a bit different than the PERS 2/3 benefit in that inflation in eight of the last seventeen years was above 3%. More recently it has been below 3%, meaning that those TRS 2/3 members who retired in 1986-1989 may experience some COLA catch-up over the next several years. Nonetheless, the benefit design allows members to retain a significant level of their original purchasing power over extended periods.

Policy Analysis

The means to protect retiree benefits from loss of purchasing power is by cost-of-living-adjustments (COLAs). The original design of TRS 1 and PERS 1 did not include an automatic COLA. This was not necessarily an oversight in the plan, which was established in 1947, but was more likely because few retirement plans had automatic COLAs at that time; even Social Security benefits were not inflation indexed until 1975. Because of the absence of an original automatic COLA, the lost purchasing power of TRS 1 and PERS 1 benefits has been addressed by frequent ad hoc efforts and sometimes complex legislation for those whose benefits had lost significant purchasing power.

The need for an automatic COLA was acknowledged in the design of the Plans 2 and 3, which include a CPI-based COLA that begins one year after retirement, including early retirement. The policy decision driving that design was that "...retiree benefits should have some form and degree of protection from inflation." In recognition of the cost of such a benefit, plan 2 design also incorporated an age-based retirement requirement (age 65 with at least 5 years of service) and did not include the service-based retirement criteria of plan 1 (30 years of service at any age).

Policy Constraints

The retirement policy that may constrain any benefit improvements in PERS 1 and TRS 1 seeks to "... fund benefit increases for plan members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service." This policy is based on the concept of inter-generational equity. As the plan 1s have been closed since 1977, as there are now more retirees than active members, and as the employee contribution rate is fixed in statute, the source of contributions to fund any improvement becomes, more and more, taxpayers who never received services from these members.

Fiscal Constraints

Because of the significant losses of purchasing power, the cost of any remedy would be similarly significant. Were it decided that PERS 1 and TRS 1 retiree allowances should not fall below 60% or their original purchasing power, then the allowances of 4,800 PERS and 3,700 TRS service retiree's would need to be adjusted. In the first year alone, the cost would be almost \$13 million dollars.

Figure 8 First Year Cost to Fund Minimum Levels of Purchasing Power For PERS 1 and TRS 1 Service Retirees (Smillions)

	Level of Original Purchasing Power		
	60%	70%	80%
PERS 1	\$4.9	\$14.5	\$43.7
TRS 1	\$8.0	\$21.4	\$50.7
Total	\$12.9	\$35.9	\$94.4

Demographic Issues

Demographic trends play a tangential role in purchasing power analysis. As retirees continue to live longer, the more inflation can erode their retirement benefits. PERS 1 members tend to retire at 60 years of age and TRS 1 members at 58.5 years of age. So on average, PERS retirees will go about 6 years before receiving their first Uniform COLA and TRS retirees will go $7\frac{1}{2}$ years. On top of that, according to the most recent life-expectancy tables, a PERS female retiring today at age 60 can expect to live another 24 years (see Figure 9). The average TRS female retiring today can expect to live another 27.1 years.

Figure 9 Life Expectancy at Average Retirement Age		
	Male	Female
PERS (age 60)	21.4	24.0
TRS (age 58½)	24.5	27.1

Comparisons with other Washington Systems/Plans

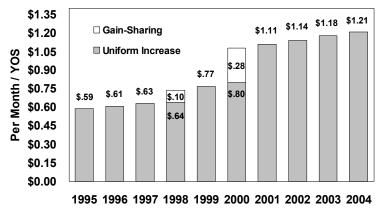
There are three post-retirement COLA designs in Washington's retirement systems: the fully indexed benefit for Law Enforcement Officers and Fire Fighter's (LEOFF) plan 1 retirees, the CPI-based 3% capped COLA for plan 2/3 retirees, and the Uniform Increase for TRS 1 and PERS 1 retirees.

The monthly retirement benefit for a member of the Law Enforcement Officer's and Fire Fighter's plan 1 is fully indexed to the CPI-W for the Seattle-Tacoma-Bremerton region. On April 1 of each year, beginning one year after retirement, the members' benefits are adjusted based on the annual percent increase in the CPI as measured over the previous calendar year.

The monthly retirement benefit for a member of the plan 2s, and the defined benefit portion of the plan 3s, is indexed to the CPI-W for the Seattle-Tacoma-Bremerton region to a maximum of 3% per year. On July 1 of each year, beginning one year after retirement, the members' benefits are adjusted based on the annual percent increase in the CPI as measured over the retiree's entire period of retirement.

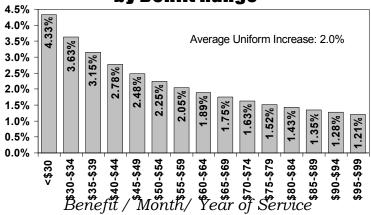
Monthly retirement benefits for PERS 1 and TRS 1 members are adjusted by what is known as the Uniform COLA. The Uniform COLA is the product of the Uniform Increase Amount multiplied by each retirees years of service (yos). The Uniform Increase Amount grows at 3% per year and is also enhanced by gain-sharing (see Figure 10).

Figure 10
PERS 1 & TRS 1
Uniform Increase Amount



Unlike the aforementioned COLAs that apply the same percent increase to each member's benefit, the Uniform increase is based solely on years of service. As a result, a retiree with 30 years of service and a low benefit will receive the same dollar adjustment as a retiree with 30 years of service and a high benefit. This rewards low benefit retirees with greater purchasing power protection than high benefit retirees (see Figure 11).

Figure 11
Uniform COLA Percent Increase
by Benfit Range



The ability of the Plan 1 Uniform COLA to protect retiree's purchasing power after age 66 is illustrated in the following Figures. The "illustrations" assume the member retires at various ages with a \$1,500/month benefit. The benefit value is deflated by the actual changes in Seattle area consumer prices as measured by the CPI-W. The member begins receiving the annual Uniform increases in 1995 when reaching age 66 (birthday prior to July 1.)

Figure 12 illustrates the deflated benefit stream of a member retiring at age 55 in 1984. At age 55 the member will have to wait 11 years before receiving their first COLA. Based on the changes in consumer prices over that period, the benefit would have declined to about \$1,059 in current value by 1995 (see Figure 12). Upon receipt of the Uniform COLA the benefit would stabilize, and by 2004 it would have retained much of its 1995 value. If not for the COLA, the benefit would have been worth just over half its original value by 2004.

Figure 12
Plan 1 Purchasing Power
For a Member Retiring at Age 55

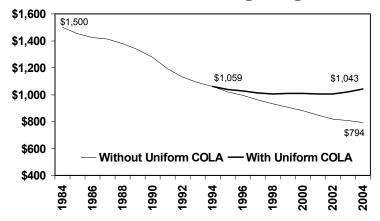
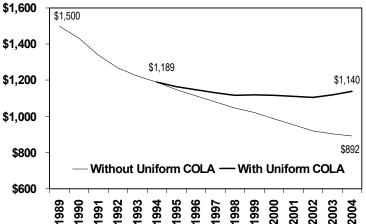


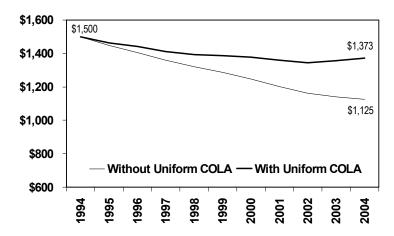
Figure 13
Plan 1 Purchasing Power
For a Member Retiring at Age 60



In Figure 13 the member's benefit loses about 20% of its original purchasing power before eligibility to receive the Uniform Increase. Even after receiving the Uniform Increase, the benefit still loses value until 2002 when it begins to recover, inching back to 76% of its original purchasing power by 2004. Were it not for the Uniform increase, the benefit would have continued to lose purchasing power, declining to less than 60% of its original value by 2004.

A member who retired at age 65 in 1994 would have an entirely different experience. By not having to wait an extended period before being eligible for the Uniform COLA, their benefit loses considerably less purchasing power (see Figure 14). By 2004, this member's benefit would be over \$250 per month above where it would have been without the COLA.

Figure 14
Plan 1 Purchasing Power
For a member Retiring at Age 65



Comparisons with Other State and City Plans

Among the eleven systems chosen to provide a standard comparison, all provide some form of COLA (see Figure 15). Five of those systems provide COLAs that are CPI based with varying caps, the highest being 6%, the lowest being 2%. The remaining systems provide percent increases that range from a low of 1.5% to a high of 3.5%. Most begin after 1 year of retirement; Florida and Idaho provide prorated COLAs for those retired less than one year.

Figure 15 COLA Provisions by Select Retirement Systems		
System COLA		
Cal PERS	2% (80% purchasing power min.)	
Cal STRS	2% simple (80% purchasing power min.)	
Colorado PERA*	3.5%	
Florida (FRS)	3%	
Idaho (PERSI)	CPI based, 1% min, 6% max,	

System	COLA
Iowa (IPERS)	Simple increase: 3% max
Minnesota (MSRS)	CPI based, 2.5% max + investment surplus
Missouri (MOSERS)*	80% of change in the CPI, 5% max
Ohio (OPERS)*	CPI based, 3% max
Oregon PERS*	CPI based, 2% max
Seattle (SCERS)	1.5% (60% purchasing power min.)

Several of the comparison systems provide protection against specific losses of purchasing power. Benefits in the California systems cannot fall below 80% of the original benefit's purchasing power. Benefits in the Seattle system cannot fall below 60% of their original purchasing power. This is similar to a 1992 COLA provision that protected PERS 1 and TRS 1 members from the loss of 40% of their age 65 benefit's purchasing power.

Human Resource Impact

The absence of a COLA for TRS 1 and PERS 1 members who retire before age 65 may have an impact on public sector human resource policies in Washington State. The post-retirement employment issue is driven by numerous factors, one of which may include a member's fear of losing the purchasing power of their benefit. Returning to work after retiring is a reasonable choice for those hoping to accrue additional assets to help cover future inflation and other fast-growing expenses.

Conclusion

The loss of a retirement benefit's purchasing power tends to be a gradual process. But even modest amounts of inflation can have significant long-term effects. Recognition of this phenomena resulted in the COLA provisions in the plan 2/3 designs, and also the most recent efforts to provide some systematic benefit protections in PERS 1 and TRS 1. The Uniform Increase provides some protection over inflation -- a phenomenon totally outside the member's control. Members may also choose the Optional COLA payment upon retirement, which gives them greater control and benefit stability. For those members retiring in the future, these provisions should reduce the anxiety of maintaining their

purchasing power. For current retirees, however, the Uniform Increase may provide some recovery of purchasing power, but it is a long ways up after such a long fall.

As PERS 1 and TRS 1 are closed plans with more annuitants than active members, additional COLA improvements would be more difficult to provide under existing funding policy.

APPENDIX A History of Post-Retirement Adjustments in TRS 1 and PERS 1

Date	TRS 1	PERS 1
3/21/61 (SERS)		Minimum pension \$900/year if retired at age 70 with 10 or more years of service \$60/month if 15-19 years of service \$70/month if 20-24 years of service \$80/month if 25-29 years of service \$90/month if 30 or more years of service
3/21/67		Minimum benefit increases to: \$60/month if 12-15 years of service \$90/month if 16-19 years of service \$120/month if 20 or more years of service
7/1/67	Pension portion of benefit increased to \$5.50/month/year of service if age 65 and not qualified for Social Security	
3/25/69		Minimum benefit increases to: \$75/month if 12-15 years of service \$100/month if 16-19 years of service \$130/month if 20 or more years of service
7/1/70	Minimum benefit revised to \$5.50/month/year of service. Applicable to members retiring before 4/1/69. Applied to the pension portion of the benefit.	The following received for each \$1 of pension by year of retirement: '49 - \$1.5239 '56 - \$1.3687 '63 - \$1.2116 '50 - \$1.5386 '57 - \$1.3485 '64 - \$1.1960 '51 - \$1.5239 '58 - \$1.3031 '65 - \$1.1813 '52 - \$1.4110 '59 - \$1.2601 '64 - \$1.1620 '53 - \$1.3805 '60 - \$1.2501 '65 - \$1.1291 '54 - \$1.3702 '61 - \$1.2116 '66 - \$1.0980 '55 - \$1.3643 '62 - \$1.2255 '67 - \$1.0536
7/1/77		5.95% COLA applied to pension portion of the benefit if retired before 12/31/70.
7/1/72	5.9% COLA for all members retired before 7/1/71, plus an additional 5.4% for those retired between 7/1/69 and 6/30/70.	
4/25/73		Minimum benefit of \$6.50/month/year of service. 3% permanent increase based on assets in excess of current liabilities.
7/1/73	\$3/month/year of service for retirees not eligible for Social Security.	Increase of 1.0609% if the member retired before 1972 and their service retirement allowance was adjusted in section (1) for adjustment made of 4/25/73.

History of Post-Retirement Adjustments in TRS 1 and PERS 1 $_{(cont)}$

Date	TRS 1	PERS 1	
7/1/74	11.9% pension increase for those retired on 6/31/70. 2.9% pension increase for those retired 7/1/70 - 6/30/73. 3% COLA on total allowance for those retired on 12/31/73.	3% COLA for those retired prior to 12/31/73	
7/1/75		3% COLA for those retired prior to 12/31/74	
7/1/76	Minimum pension benefit of \$7.50/month/year of service if retired prior to 4/25/73.	3% COLA for those retired prior to 12/31/75	
7/1/77	Minimum pension benefit of \$8.00/month/year of service if retired prior to 4/25/73.	3% COLA for those retired prior to 12/31/76	
7/1/78		3% COLA for those retired prior to 12/31/77	
7/1/79	Minimum pension benefit of \$10/month/year of service for retirees of 7/1/79. Disability and survivor benefits as of 12/31/78, and service benefits as of 7/1/74 permanently increased by \$0.8171 multiplied by the member's years of service.	Minimum pension benefit of \$10/month/year of service for retirees of 7/1/79. 3% COLA for those retired prior to 12/31/78.	
7/1/80		3% COLA for those retired prior to 12/31/79.	
7/1/81		Excess earnings adjustment no longer in effect as employer contribution rate increased above rate of 4/24/73.	
7/1/83	\$0.74/month/year of service COLA to disability and survivor benefits being received on 12/31/82 and service retirement benefits being received on 7/1/78.		
7/1/86	Minimum benefit increased to \$13.00/month/year of service		
7/1/87	Permanent automatic 3% annual increase to the minimum benefit becomes effective. Minimum pension benefit increased to \$13.50/month/year of service.		
7/1/88	Minimum pension benefit increased to \$13.82/month/year of service.		
7/1/89	Minimum pension benefit increased by \$1 to \$14.91/month/year of service and then increased 3% to \$15.36/month/year of service. Permanent automatic COLA enacted for retirees whose age 65 purchasing power had been reduced by more than 40%.		
7/1/90	Minimum pension benefit increased 3% to \$15.72/month/year of service. 3% COLA for eligible retirees.		
7/1/91	Minimum pension benefit increased 3% to \$16.19/month/year of service. 3% COLA for eligible retirees.		
2/1/92	The current benefits of those eligible for the COLA adjusted to be equal to 60% of their age 65 retirement allowance.		
7/1/92	Minimum pension benefit increased 3% to \$16.68/month/year of service. 3% COLA for eligible retirees.		

History of Post-Retirement Adjustments in TRS 1 and PERS 1 (cont)

Date	TRS 1	PERS 1
7/1/93	Minimum pension benefit increased 3% to \$17.18/month/year of service. 3% COLA for eligible retirees. Continuation of special adjustment effective 2/92. Temporary ad hoc COLA effective through 6/30/94, \$3/month/year of service for those retired 5 years, who were 70 years of age, and did not receive a COLA in 1992.	
7/1/94	Minimum pension benefit increased 3% to \$17.70/month/year of service. 3% COLA for eligible retirees. Special adjustment effective 2/92 made permanent. Temporary ad hoc COLA extended to 6/30/95. Provides \$3/month/year of service to eligible retirees.	
7/1/95	Uniform Increase established. Initial increase of \$0.59/month/year of service to be increased by 3% per year. Retirees are eligible for the Uniform Increase if they have been retired at least one year and are age 66 by July 1 st in the calendar year in which the annual increase is given, or if their retirement allowance is lower than the minimum benefit amount Minimum benefit increased to \$24.22/month/year of service, and to automatically increase each year by the Annual Increase amount. Temporary ad hoc COLA that had been extended to 6/30/95 made permanent.	
7/1/98	Gain-sharing established, providing even-year enhancements to the Annual Increase amoun based on half the compound average investment returns in TRS 1 and PERS 1 plan assets over the previous four fiscal years that exceed 10%.	
7/1/04		nefit payments) established for retirees with 25 ement. Does not include an automatic increase. m increases to \$40/month/year of service.



Purchasing Power

Robert Wm. Baker Senior Research Analyst

Select Committee on Pension Policy July 13, 2004

Purchasing Power

... the measure of how a benefit retains its value over time.

Members Impacted

- 21,737 active and 54,006 retired PERS 1 members
- 12,456 active and 33,148 retired TRS 1 members.

Uniform Increase

- \$1.21 per month per year of service (July 1, 2004)
 - \$36.30 per month for member w/30 yos
- Began in 1995 at \$0.59
- Increases 3% per year
- Augmented by gain-sharing

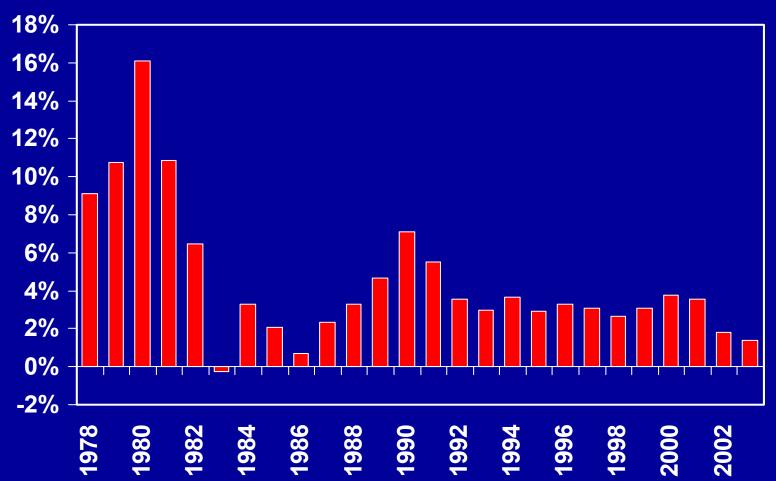
History

- 1961: \$900 per year minimum for a member who retired at 70 years of age with 10 years of service
- 2004: \$1,000 per month minimum for a member retired at least 20 years after
 25 years of service
- See Appendix A in report

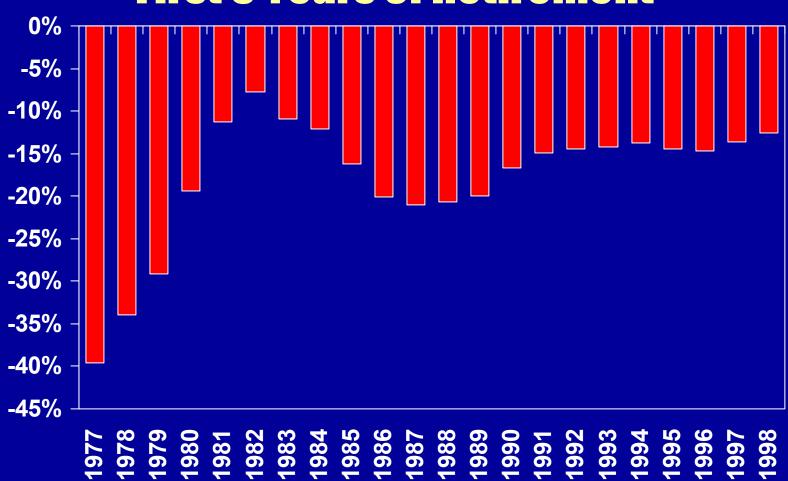
Current Efforts

- Increase frequency of gain-sharing to include odd-numbered years
- Lower threshold for determining when gain-sharing can occur.

Annual Percent Changes Seattle CPI-W: 1978 - 2003



Purchasing Power Loss In the First 5 Years of Retirement



Purchasing Power Calculation

(Current Benefit / Original Benefit) × (Original CPI / Current CPI)

Current Benefit: \$1,164

Original Benefit: \$1,002

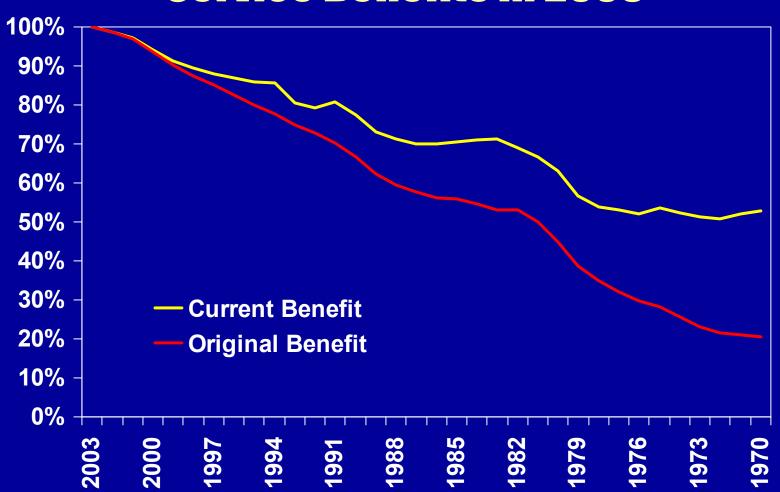
Original CPI-W: 369.0

Current CPI-W: 553.6

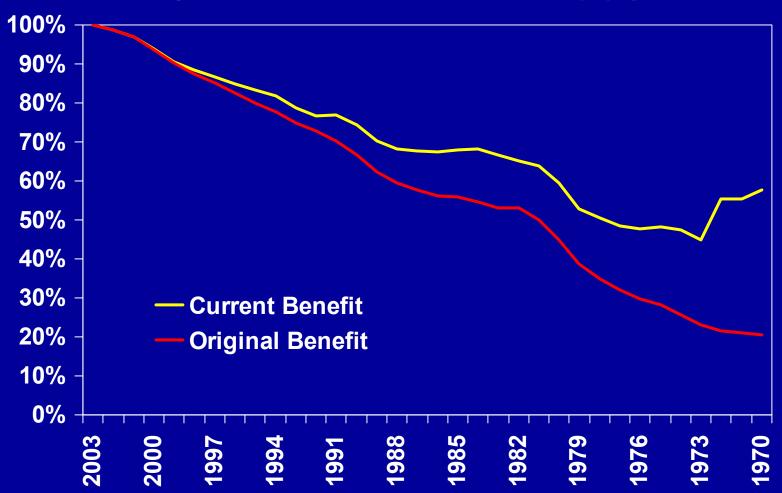
 $($1164 / $1002) \times (369.0 / 553.6)$

116.2% × 66.7% = **77.43%**

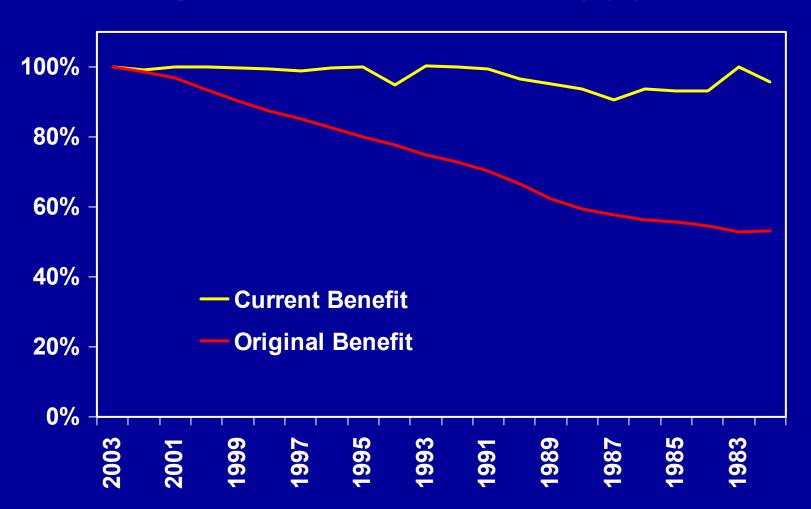
Purchasing Power of PERS 1 Service Benefits in 2003



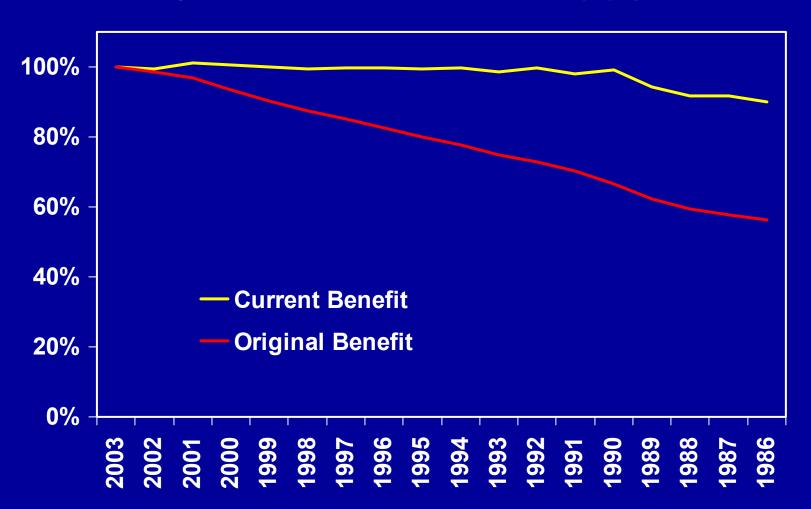
Purchasing Power of TRS 1 Service Benefits in 2003



Purchasing Power of PERS 2/3 Service Benefits in 2003



Purchasing Power of TRS 2/3 Service Benefits in 2003



Plan 1 Retirement Policy

- Prior to 1995
 - Ad hoc
 - Protection for those who lost the most
 - Loss of 40% of purchasing power after age 65
- Beginning in 1995
 - Service based rather than salary based
 - Greater protection for lower benefit retirees

Plan 2 Retirement Policy

"...retiree benefits should have some form and degree of protection from inflation."

Policy Constraints

"... fund benefit increases for plan members over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those members' service."

First Year Cost to Fund Minimum Levels of Purchasing Power (\$ millions)

	Level of Original Purchasing Power		
	60%	70%	80%
PERS 1	\$4.9	\$14.5	\$43.7
TRS 1	\$8.0	\$21.4	\$50.7
Total	\$12.9	\$35.9	\$94.4

Life Expectancy at Average Retirement Age

	Male	Female
PERS (age 60)	21.4	24.0
TRS (age 58½)	24.5	27.1

LEOFF 1 COLA Benefits

Benefit fully indexed to the Seattle CPI-W

Plan 2 COLA Benefits

After 1 year of retirement, annual increases based on the Seattle CPI-W to a maximum of 3% per year

Plan 3 COLA Benefits

After 1 year of retirement, annual increases in the defined benefit portion based on the Seattle CPI-W to a maximum of 3% per year

PERS 1 & TRS 1 COLA Benefits

Uniform Benefit: At age 66, after 1 yr of retirement, a dollar amount per month per year of service increased each year by 3%

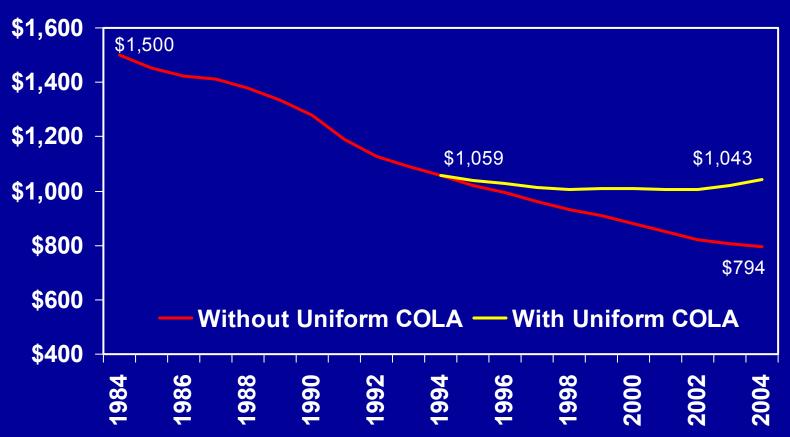
PERS 1 & TRS 1 Uniform Increase Amount



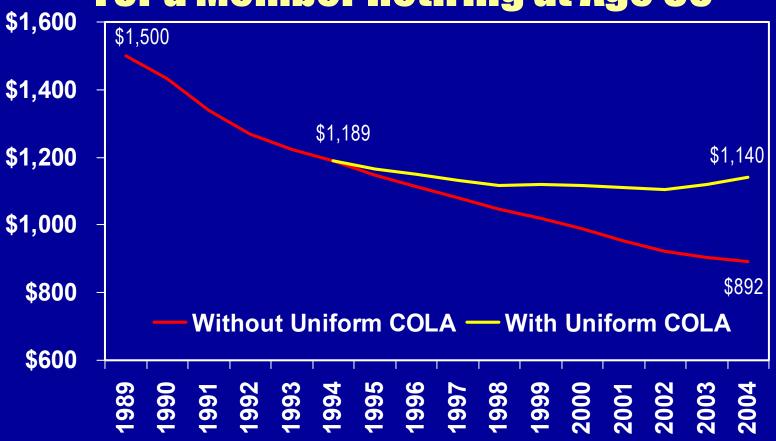
Uniform COLA Percent Increase by Benfit Range



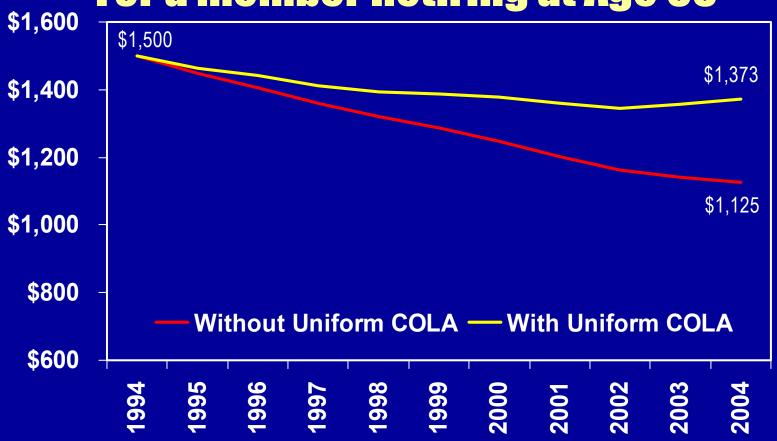
Plan 1 Purchasing Power For a Member Retiring at Age 55



Plan 1 Purchasing Power For a Member Retiring at Age 60



Plan 1 Purchasing Power For a member Retiring at Age 65



Comparison Systems

System	COLA	
Cal PERS	2% (80% purchasing power min.)	
Cal STRS	2% Simple (80% purchasing power min.)	
Colorado PERA	3.5%	
Florida (FRS)	3%	
Idaho (PERSI)	CPI-based, 1% min, 6% max	
Iowa (IPERS)	Simple increase, 3% max	
Minnesota (MSRS)	CPI based, 2.5% max + invest surplus	
Missouri (MOSERS)	80% of change in the CPI, 5% max	
Ohio (OPERS)	CPI based, 3% max	
Oregon PERS	CPI based, 2% max	
Seattle (SCERS)	1.5% (60% purchasing power min.)	

Human Resource Impact

Loss of their benefit's purchasing power one factor in retirees returning to work.

Conclusion

- Loss of purchasing power can be gradual
- Modest inflation has large long-term effects
- Recognition of inflationary effects has spurred efforts
- Funding policies may constrain future efforts

Select Committee on Pension Policy

Post-Retirement Employment

(July 7, 2004)

Issue

This report is intended to supplement the indepth report on this issue made to the Select Committee on Pension Policy in December 2003. A copy of the December Report is attached. This report will recap the issue in a simplified way, then discuss some of the more sensitive aspects of post-retirement employment. Post-retirement employment is a controversial subject, not only within the state of Washington but throughout the entire country. This paper will explore some of the difficult policy questions that arise in connection with this issue, as well as some of the legal constraints and technicalities that are applicable. It will also touch on some of the trends that are pressuring policy makers to continue to address the issue of post-retirement employment.

Staff

Laura Harper, Sr. Research Analyst/Legal 360-586-7616

Members Impacted

Recent legislative activity has focused on Plan 1 of the Teachers' Retirement System (TRS 1) and Plan 1 of the Public Employees' Retirement System (PERS 1). As of the most recent actuarial valuation (2002), there were 12,456 active members and 33,148 retirees in TRS 1. There were 21,737 active members and 54,006 retirees in PERS 1.

Current Situation

Generally, all retired members of PERS and TRS have a **waiting period** before they may return to employment. In most instances, the waiting period is thirty (30) days. If retirees return to work prior to completion of the waiting period, their benefits are effectively suspended due to mandatory reductions in the benefit amounts (5.5% for every eight hours worked during that month to a maximum of 160 hours in PERS, and 5.5% for every seven hours worked during the month to a maximum of 140 hours in TRS).

The PERS and TRS systems allow retirees to return to employment, but there are limits on the number of hours that may be worked without suspension of retirement benefits. The **hour limits** start over with each new calendar year and vary among the plans. Generally, for the Plans 2/3 the hour limit is 867 hours. For the Plans 1, retirees may work up to a limit of 1,500 hours without suspension of their pension benefits, however they are subject to limits on their **contractual** rights to return to work of 5 months in PERS 1 and 525 hours in TRS 1.

PERS 1 retirees are subject to more specific rules affecting waiting periods and hour limits. Those seeking to return to work for 1,500 hours are subject to a 90-day waiting period. Also, these employees are subject to a 1900-hour cumulative or "lifetime" limit on the number of hours that may be worked beyond 867 hours annually. Once the 1,900 hour limit is reached, PERS 1 retirees may work up to 867 hours in subsequent calendar years before their benefits are suspended. PERS 1 retirees are also subject to an amended definition of "separation from service" so that any written or verbal agreement to return to work with the same employer nullifies the separation and creates a potential violation of the statute entitled "Penalties for False Statements," RCW 41.40.55. Further, employers are subject to certain record-keeping requirements when they hire these retirees to work for 1,500 hours, including documentation of the need to hire the retirees and records of the actual hiring process.

Simplified History

The door to post-retirement employment was first opened in the mid-1960's. Since then, there have been numerous changes to the pertinent plan provisions, most of which involved the length of the waiting period and the

limits on the numbers of hours that may be worked before retirement benefits are suspended. A complete history is found in the December 2003 Post-Retirement Employment Report to the SCPP that is included with this report.

In 2001 Washington State pension law was changed to expand post-retirement employment opportunities for members of TRS 1 and PERS 1. The hour limits for these plans were increased to 1,500. The earlier limits had been 5 months for PERS 1; in TRS 1 the limits had been 525 hours for substitute teachers, 630 for substitute administrators and 840 for substitute teachers or principals in school districts with documented labor shortages. The new limits under the 2001 law translated to nine months in PERS 1 and a complete school year for TRS 1.

The 2001 law called for the Office of the State Actuary to study the fiscal and policy impacts of the act. If the State Actuary determined that the expansion of post-retirement employment options resulted in increased costs for the state retirement funds, the Actuary would propose a process to charge the employers for the costs incurred. The Select Committee on Pension Policy heard its first report in 2003. At its meeting on December 16, 2003, the SCPP decided to defer action until further data and study was available, as there was an insufficient amount of experience data to determine the cost.

Further legislative changes involving post-retirement employment occurred in 2003, and these changes only affected members of PERS 1. The changes were applicable to those PERS 1 retirees seeking to work up to the new limit of 1,500 hours, and they are described above under "Current Situation." Similar changes had been proposed in 2003 for TRS 1 but were vetoed. During the 2004 legislative session HB 2640 was introduced to reinstate most of the TRS 1 restrictions that had been vetoed by the Governor in 2003. This bill died in House Appropriations.

Fiscal Impact of 2001 Legislation: Indeterminable at This Time

One of the keys to determining cost is experience data. Typically actuaries study retirement plan experience every 5 to 6 years and adjust long-term retirement assumptions based on actual retirement experience.

Generally, post-retirement employment provisions generate a cost to the retirement system when they cause a significant increase in the number of retirements over what is assumed under normal long-term plan experience.

The 2001 legislation that expanded post-retirement employment opportunities for members of PERS 1 and TRS 1 included a study mandate directing the State Actuary to determine whether new provisions have resulted in increased costs for the state retirement funds, and if so, to propose a process to charge those employers who employ retirees pursuant to the new provisions.

As indicated in the Post-Retirement Employment Report dated November 24, 2003, there was an insufficient amount of experience data to reach a reliable conclusion on the question of cost at that point in time. At its December 16, 2003 meeting, the Select Committee decided to defer action until further data and study is available. As of the date of this report, the Office of the State Actuary has collected a total of nine quarters (2.25 years) of data. A minimum of five years of experience data is needed.

Current Data

While additional data has been gathered since the December 16, 2003 meeting, this data appears to be largely consistent with what had been gathered before. Again, the preliminary nature of the data should be emphasized. Nine quarters of data is not sufficient to reliably establish whether new employment trends or retirement patterns have been created as the result of the 2001 and 2003 legislation. For examples of the types of data that are being collected, see pages 13-17 of the December 2003 Report.

Policy Analysis

The following discussions were not highlighted in the December 2003 report. They include a review of policy and plan design issues, legal issues and trends.

Post-retirement employment is one of the most controversial issues that public pension policy-makers face. The controversy arises when the retired employee is allowed to draw a retirement benefit while earning a salary, and in some instances, while accruing another benefit. There are at least **two philosophies of post-retirement employment:**

- 1) "They earned it and the benefit is paid for, so why not?"
- 2) "If it's not restricted, it leads to double dipping and abuse."

Proponents of the first view tend to be those who favor a **service-based** retirement plan. Service-based retirement is not tied to age but to the number of years served. The philosophy is that once a public employee has reached a certain number of years of service, that employee should be able to retire regardless of how old the employee is. These plans may be funded based on the assumption that members will retire when they first become eligible, which may result in higher contribution rates. Average retirement ages for these kinds of plans will be slightly younger than for aged-based plans. Having retirees return to work without suspension of the pension benefit may not be considered objectionable because there is confidence that the retiree's pension has already been paid for.

Proponents of the second view tend to favor **age-based plans**. They prefer to avoid situations that involve the re-employment of public employees who have already retired, and often seek to retain workers in the system until they reach what is deemed to be an appropriate normal retirement age. Age-based plans tend to provide mechanisms for members to continue to accrue benefits for working more years and later in life. Such plans may even discourage or penalize those who seek to retire early. Proponents of the second view may seek to forbid post-retirement employment altogether unless the retirement benefit is suspended. Under the second view, if post-retirement employment is allowed, it may be restricted to part-time by imposing hour limits or earnings tests that trigger suspension of the retirement benefit.

A. Plan Design in PERS and TRS

There are significant differences in plan design between the TRS and PERS Plans 1 and the Plans 2/3. Generally speaking, the retirement provisions for the Plans 1 are more service-based, while the retirement provisions for the Plans 2/3 are more age-based.

Plan 1 retirees have a benefit formula that restricts benefit accruals after 30 years. Eligible Plan 1 retirees receive 2% of average final compensation (AFC) for each year of service credit to a maximum of 60% of AFC. There is less incentive for Plan 1 members to continue to work once they have reached thirty years of service. Furthermore, there are no early retirement provisions in TRS and PERS Plans 1, nor are there any reductions for retiring at earlier ages. Members are eligible for normal retirement at age 60 with five years of service, age 55 with 25 years of service, or at any age with 30 years of service. The plan design does not focus on or encourage working until age 65 and beyond.

Because retirement in the Plans 1 is more service-based, members tend to retire at earlier ages. Those who retire at earlier ages are more likely to seek opportunities to return to work. If they have already retired, they will prefer plan provisions that allow working **after** retirement, such as the post-retirement employment provisions that have been implemented for the Plans 1.

In contrast to the Plans 1, the Plans 2 have no cap on AFC. Members receive 2% of AFC for each year of service for as long as they continue to work. Thus a member who continues to work after qualifying for normal retirement will continue to accrue a significant increase in the monthly retirement benefit for working past age 65. In the Plans 2, members are eligible for normal retirement at age 65 with five years of service. The Plans 2 have provisions for early retirement, but the benefits are significantly reduced when members retire early. In summary, Plan 2 members are rewarded for working past age 65 by accruing additional benefits, while their benefits will be significantly reduced for retiring early. Plan provisions are aimed more at **retaining** older workers so they will retire later.

Similarly, in the defined benefit component of the Plans 3 there is no cap on the average final compensation. Eligible retirees receive 1% of AFC for each year of service, regardless of how long they work. Normal retirement is at age 65 with 10 years of service, and benefits are significantly reduced for retiring early. The vesting period is 5 years for those who complete 12 service credit months after attaining age 54. With respect to the defined contribution component, there is immediate vesting. Generally, under the Plans 3, members will accrue greater benefits by working until age 65 or longer.

B. Legal/Technical Issues Arising in Connection with Post-Retirement Employment

Policy makers who adopt post-retirement employment provisions for their plans that allow re-employed retirees to draw their retirement allowances while earning a salary and/or accruing additional benefits are faced with certain legal issues that arise in connection with the practice. They may also be challenged with public relations issues if there is any perception of potential or actual abuse.

1. <u>Prohibition Against In-Service Distributions</u>

A tax issue may arise in the context of retirees who return to work, especially those who return to the same position or to the same employer. Federal tax law prohibits qualified plans from distributing retirement income to members who are still "in service." This rule is known as "prohibition against in-service distributions," and is the genesis of the requirement that each employee have a bona fide termination of employment and actually retire prior to receiving a pension. Theoretically, a retirement plan can lose its qualified status under Section 401(a) of the Internal Revenue Code for violating this rule, resulting in significant tax liabilities for employers and employees.

The resolution of whether there is a true separation from service is to be based upon all the facts and circumstances in each individual case. There is no IRS guidance on what constitutes a sufficient "waiting period" between retirement and post-retirement employment. This is because the waiting period is only one of many facts relevant to the issue of whether the recipient of the retirement allowance has actually retired.

An employer and employee may violate the federal rule even when a statutory waiting period has been observed. For example, the employee may leave employment pursuant to a preexisting agreement that the employer will hire the employee back shortly after expiration of the waiting period. In such an instance, the rule would be violated. While a statutory waiting period can eliminate some compliance problems, it is not determinative of whether there has been a bona fide termination of employment.

DRS data for the last nine quarters shows that for both PERS 1 and TRS 1, roughly 70% of retirees are returning to work with the same employer. Thus, there is an increased possibility of violating this federal rule within the Plans 1. In Washington, only PERS 1 members are subject to a potential penalty for having a written or oral agreement that would negate a bona fide separation from service. Such an agreement could theoretically be prosecuted as a gross misdemeanor. As of the writing of this report, there does not appear to be any record of a successful prosecution under this provision.

Another approach to enforcement would be to adopt a model similar to that used by the California Public Employees' Retirement System (CalPERS). The CalPERS statute authorizes the retirement board to establish the criteria under which a bona fide separation from service is satisfied. If there is a failure to satisfy the criteria, the retired member is required to reimburse the retirement system for any retirement allowance received during the period of violation; pay the contributions that would have been required for the period, plus interest; and contribute toward reimbursement of the retirement system for administrative expenses incurred in responding to the violation, to the extent the member is determined to be at fault. Violations are handled as administrative, not criminal matters.

2. Inconsistencies in Statutory Framework

A technicality that creates inconsistencies in post-retirement employment practices has to do with membership eligibility. Generally, a retiree who becomes re-employed in an "eligible position" becomes subject to the post-retirement employment restrictions of that retirement system. Membership eligibility is a threshold determination, and in most cases, determining eligibility in the various retirement systems is a straightforward matter. When a person is working in a position that is membership-eligible, the person is reported by the employer to the Department of Retirement Systems. Pension benefits will be suspended when a retiree who is re-employed in an eligible position reaches the applicable hour limits.

Ineligible positions may include not only part time positions, but also certain full time public positions that are covered under another retirement system. Retirees may work as many hours as they want in this latter category without affecting their retirement allowances. For example, the **higher education institutions** are authorized by RCW 28B.10.400 to make separate retirement income plans available to their professional and academic employees instead of PERS or TRS. These institutions determine who is eligible to participate in their higher education retirement plans. An example is found in WAC 415-108-710, which provides that a PERS retiree may work after retirement and

continue to receive a retirement allowance if the member becomes an active member of a higher education retirement plan and is employed no sooner than one calendar month after the member's retirement benefit accrues.

This distinction may be seen by some as a legal "loophole." The practice was recently highlighted in the media as illustrated in the attached transcript entitled "Tripple dipping at UW," May 24, 2004, which may be found at www.king5.com (scroll down to Local News then King 5 Investigators). The story incorrectly attributed the retirerehire activity at UW to "a 2001 state law."

The return-to-work legislation that was passed in 2001 did not create the ability for the employees identified in this media account to return to work without suspension of their retirement benefits. Instead, that ability is the result of the long-standing provisions in state law allowing higher education institutions to sponsor their own retirement plans and to promulgate their own rules determining who is eligible to participate in the plans. It is the statutory flexibility given to higher education plans that enables these re-employed retirees to begin accruing benefits in the higher education retirement plan while still receiving their pensions.

The operation of the estoppel statute further highlights this inconsistency with respect to post-retirement employment. **Estoppel** is an archaic term that simply means "stopped," "blocked" or "not allowed." It is derived from a doctrine of law that prevents a party from taking a certain action because it is not fair or just. Washington's retirement law includes a general estoppel rule related to post-retirement employment that was passed in 1976.

RCW 41.04.270 prohibits any member or former member from becoming a member or establishing any contractual rights in another public retirement system listed in RCW 41.50.030 (DRS-administered plans) or first class city systems if:

- the person is retired or eligible to retire (under normal, early and alternate early retirement provisions) from a public retirement system; or
- the person receives a disability allowance from a pubic retirement system.

The estoppel rule also provides that persons receiving a benefit or who are eligible to receive a benefit are not subject to the provisions of the statute if the person accumulated less than 15 years of service.

The higher education plan is not covered by this estoppel rule. The estoppel rule is found in the "General Provisions" of Chapter 41.04, RCW, and is not applicable to the higher education plan, which is found in Chapter 28B.10, RCW. By its terms, the estoppel rule is only applicable to DRS-administered plans and the city employee retirement systems of Seattle, Tacoma and Spokane. This means, for example, that a PERS 1 retiree who is rehired and becomes an active member of a higher education plan is not prohibited by the estoppel rule from earning additional benefits while drawing a PERS 1 retirement allowance.

3. <u>Contractual Rights</u>

A third area of legal concern to policy makers adopting post-retirement employment provisions into their retirement plans is the issue of vested or contractual rights. Expanding the opportunity to engage in post-retirement employment may be seen as an expanded benefit. As a general matter, once a new retirement benefit has been granted, it cannot be withdrawn without violating the principle set forth in Bakenhus v. City of Seattle, the Washington Supreme Court case that established pension provisions as an integral portion of the contemplated compensation set forth in the contract of employment.

The 2001 legislation that expanded the number of hours PERS and TRS Plan 1 retirees could work before having their benefits suspended included language to limit the affected employees' ability to rely on the expansion as part of their employment contract. The legislation included a "no contractual right" clause. This clause stated that the legislature reserved the right to amend or repeal the provision. The clause further provided that no member or beneficiary of PERS 1 has a contractual right to be employed more than five months in a calendar year without a reduction of his or her pension, and no TRS 1 member or beneficiary has a contractual right to be employed more than 525 hours per year without a reduction of his or her pension. The ability of the legislature to restrict employee reliance upon legislation expanding pension benefits by utilizing a "no contractual right" clause has not yet been tested in the Washington courts.

There are at least two approaches that may be used when lawmakers wish to provide a benefit that may be subsequently taken away. One is to use the "no contractual right" clause. The advantage is that employees are notified up front that they cannot rely on the newly created benefit. The disadvantages of this approach include legal uncertainty and a risk of litigation. In addition, by creating benefits with an uncertain legal status, there is the possibility of violating the federal tax rule requiring that benefits be "definitely determinable," another plan qualification requirement of federal tax law.

An alternative approach is to create temporary pension rights, specifying a window of time within which the rights would be available and then expire. This approach has the advantage of being more certain, but a disadvantage is the need for the legislation to be amended or renewed over time. This approach also creates questions of equity, in that not all members have the opportunity to take advantage of the expanded benefit. Some members will fall within the window and some will not.

A recent U.S. Supreme Court case that was decided in June of this year is worthy of being mentioned, as it reiterates the point that currently accrued benefits must not be affected when post-retirement employment opportunities are expanded and then reduced. The case involved a private

plan rather than a public pension plan, and was decided under the "anti-cutback rule" of ERISA (Employee Retirement Income Security Act). ERISA is not applicable to governmental plans. The case is relevant, however, because ERISA cases may be used as persuasive authority in public pension cases when there is no public pension plan law that is directly on point. The anti-cutback rule is the private sector equivalent of Washington's <u>Bakenhus</u> rule.

The case of <u>Central Laborers' Pension Fund v. Heinz, et al.</u> involved a plan amendment that expanded the kinds of disqualifying employment that would trigger a suspension of benefit payments. In this case, the contested plan amendment was made subsequent to the early retirement of two participants. The court found that the retirees had justifiably relied on the terms of the plan at the time they retired, and that the subsequent plan amendment had effectively reduced their benefits. The Supreme Court cited as support Treasury regulations under Internal Revenue Code Section 411(d)(6) that flatly prohibit plans from attaching new limiting conditions to benefits that an employee has already earned.

C. Comparison with Other Retirement Systems

Many states have adopted a waiting period for post-retirement employment in order to minimize the possibility of making inservice distributions in violation of plan qualification guidelines. Ohio has a two-month waiting period, Colorado and Florida have a one-month waiting period, and Minnesota's waiting period is 14 days. Not all retirement systems adopt a specific waiting period. For example, California PERS' statute simply requires that there be a bona fide separation in service. A proposed administrative rule is pending that would require a 60-day waiting period.

The following table contains a more general description of postretirement employment restrictions in other comparative retirement systems. Compared to the provisions in other states, Washington's post-retirement employment rules are not atypical.

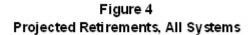
Rehire Provisions from Select Comparison Systems		
State / System	Post-Retirement Employment Restrictions	
CalPERS	May work 960 hours; some positions without restriction	
CalSTERS	May earn a maximum of \$25,740	
Colorado PERA	May work 110 days or 720 hours; some positions without restriction	
Florida (FRS)	May work 780 hours; some positions without restriction	
Idaho PERSI	May work less than 20 hours/week or 5 consecutive months; less than one-half contract for teachers	
Iowa PERS	Ages 55-65 may earn greater of \$30,000 or current SS limit; no limit after 65	
Minnesota SRS	Under 65 may earn up to \$11,280 as indexed by SSA; no limit after 65.	
Missouri (MOSERS)	May earn additional service credit but pension is suspended; some positions without restriction	
Ohio PERS	Retiree becomes a contributing member; some positions are without restriction	
Ohio STERS	Retiree becomes a contributing member and may receive contributions as a lump sum or an annuity	
Oregon	May work 1,039 hours; no restriction for those over age 70; some positions without restriction	
Seattle	May work 1,040 hours	

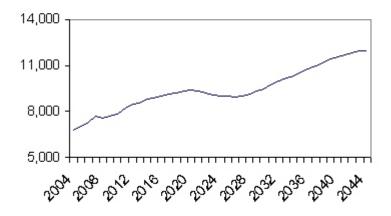
Within this comparison, some states allow retired members to return to work up to a maximum number of hours without having their pension suspended; others allow a member to earn a maximum dollar amount. Some allow members to return to work full time upon suspension of the retirement benefit, and contributions to the retirement system are required during the period of post-retirement employment. Some states have eliminated restrictions for older retirees. Most states have more liberal post-retirement employment provisions for teachers than for other public employees. In fact, according to National Council on Teacher Retirement, all 50 states allow some form of post-retirement employment for teachers.

D. Economic, Demographic and/or Social trends

Washington's 2001 legislation that expanded post-retirement employment opportunities was largely in response to a shortage of experienced teachers and other employees that were in high demand during the most expansive point in the last business cycle. The following discussion is intended to highlight some of the current trends that continue to create pressure on policy makers as they address the issue of post-retirement employment. This is not to suggest that policy makers must respond to such pressures, or that there is a right or wrong way to respond. The purpose of this section is simply to highlight some of the developments that continue to bring the issue of post-retirement employment to the forefront.

In the State of Washington, the total number of retirements for all public employee retirement systems is projected to steadily increase over the next forty years. The following chart shows the projected retirements from active status based on data from the 2002 Actuarial Valuation:





This steady projection does not portend a massive looming labor shortage in the government workforce. However there is some concern that imminent baby boomer retirements will create a shortage of experienced workers.

The Washington Department of Personnel's Task Force on the Impact of Aging Trends on the Washington State Government Workforce (June 2000) found the following:

- The state will experience significantly higher turnover due to increasing retirement rates, with some agencies and job categories impacted to a much greater extent than others.
- In 18 agencies, including some of the state's largest, 15-29% of the PERS Plan 1 workforce will be eligible to retire by 2005.
- More than 50% of executive level and 30% of mid-level managers will be eligible to retire by 2005.
- Over 50% of the state workforce is in the 40-54 age group and at the mid-career stage or more.

The 2000 Task Force had several recommendations that are relevant to the issue of post-retirement employment and the relatively recent expansion or post-retirement employment opportunities in the State of Washington:

- Hire retirees as a source of experienced workers.
- Eliminate barriers to using retirees as part-time workers by reducing restrictions on post-retirement employment and/or allowing exceptions so that agencies can provide health care coverage as an incentive for retirees to work part-time.
- Explore options to help retain experienced workers, such as scheduling flexibility, telecommuting, assignment or career changes, leave options and downshifting.

Whether older workers retire and return to work, or whether they are given incentives to remain within the workforce, the trend in Washington and throughout the country is toward an aging workforce. Both public and private employers are concerned with sector shortages that may result from an increase in the retirement

rate for baby boomers, and are looking for ways to keep experienced workers involved. See Adequacy of Retirement Benefit Report to the SCPP, June 2004.

Employees are also indicating a desire to work longer. Among 2,001 workers between the ages of 50 and 70 recently polled by AARP, nearly 70% said they planned to continue working past the age of 65, and almost half said they envisioned working into their 70s or beyond. Pre-retirees cited various reasons for believing they will continue to work, including needing money (22%), needing health benefits (17%), staying mentally active (15%), being productive or useful (14%), and remaining physically active (9%).

The changing workforce is further reflected in changes to the federal Social Security law as of January 2000 that eliminated the Retirement Earnings Test for individuals age 65-69. (It remains in effect for those ages 62-64). This test had required that if seniors continued to work from age 65 to 70, their benefits were reduced \$1 for every \$3 earned above \$17,000. The withheld benefits were then returned, in general with interest, in the form of higher benefits after stopping work, or at age 70.

The test was not eliminated because older Americans aren't working. Rather, the law eliminating the test - the Senior Citizens' Freedom to Work Act of 2000 - was touted as "an important step toward preparing the economy for the demographic challenge of the baby boom." At that time there were 9.6 million people between the ages of 65 and 69, of which 3.0 million were working in Social Security covered employment. The number of people in that age group was projected to double to 20.3 million by the year 2030. National Economic Council, April 6, 2000.

Finally, a recent Watson Wyatt study of workers at or near retirement age indicated that a majority of survey participants would like to work fewer hours later in their careers, but less than half of them expect their employer to offer this opportunity. When asked how they would like to phase into retirement, many older workers said they hope to work part-time (63%) or work more flexible hours (48%) before retiring completely. Nearly 2/3 (63%) of current workers aged 50 and older indicated that they would like to phase into an entirely different career. Among those currently

participating in phased retirement, 80% work flexible hours and 79% work part-time. Two-thirds (67%) have less responsibility in their current job compared with their career job. See "Older Workers Would Delay Retirement if Employers Offered Phasing," Watson Wyatt Press Release, March 22, 2004.

E. Challenges in Responding to Trends

Most retirement experts agree that the aging workforce is a trend that is causing some to question how retirement plans and benefits programs are structured. The challenge for policy makers is to distinguish short-term cycles from long-term trends.

Public pension plans are designed and funded over multiple decades. Frequent changes in the benefit structure of public pension plans can contribute to contribution rate instability and inadequacy, as well as possible generational inequities in terms of taxpayer funding. Also, because of well-established legal principles recognizing the contractual nature of pension benefits, it is virtually impossible to take away benefits once they have been given. Even if benefit reductions are prospective and apply only to new hires, there is political difficulty in offering less to new employees than what has been previously offered.

Part of the philosophical debate surrounding post-retirement employment practices is whether retirement systems should be used as a tool in solving personnel issues. Proponents argue that retirement benefits are part of the total compensation package and should be used to address the needs of a changing workforce. Opponents argue that compensation issues should be addressed directly through salary increases, and retirement systems should be utilized only for retirement, i.e. providing security to employees who are no longer working.

F. Public Relations Issues

As one of the more controversial issues for public pension systems, "retire-rehire" has received considerable attention in the press. Washington is no exception. Washington's expanded post-retirement employment opportunities have been the subject of analysis in Governing Magazine (July 2003). They have been highlighted in numerous newspaper articles and editorials, including those published by the Olympian (September 9, 2002), Seattle Times (January 30, 2003 and February 1, 2002), the News Tribune (April 21, 2003), the Columbian (September 26, 2002), and the Daily of the University of Washington (May 7, 2004). They have also been the subject of a King5 Investigative Report (May 24, 2004, transcript attached). Managing public relations is another one of the many challenges for policy makers who tackle the controversial issue of post-retirement employment.

Conclusion

Retire/rehire provisions are used to attract retired workers back to the work force **after retirement**. They tend to be used with plans that have service-based retirement provisions as in the Plans 1 for TRS and PERS. Washington recently expanded opportunities for PERS and TRS Plan 1 retirees to return to work, and the State Actuary is monitoring the impacts of this legislation. Another category of tools is used to **retain** older workers who are still in the workforce. These types of provisions may involve increased benefit accruals for those working longer periods of years and later in life. Some of these kinds of provisions are already built into the Plans 2/3 of the Washington State Retirement Systems.



Post-Retirement Employment

Laura Harper Senior Research Analyst

Select Committee on Pension Policy July 13, 2004

Scope of Report

- Supplemental to 2003 Report
- Refresher:
 - Where are we?
 - How did we get here?

Policy Discussion

- Philosophical approaches
- Role of plan design
- Legal constraints
- Updated comparisons
- Trends
- Challenges

Current Situation

Focus is on PERS and TRS Plans 1

Two basic elements

waiting period

- hour limits

History

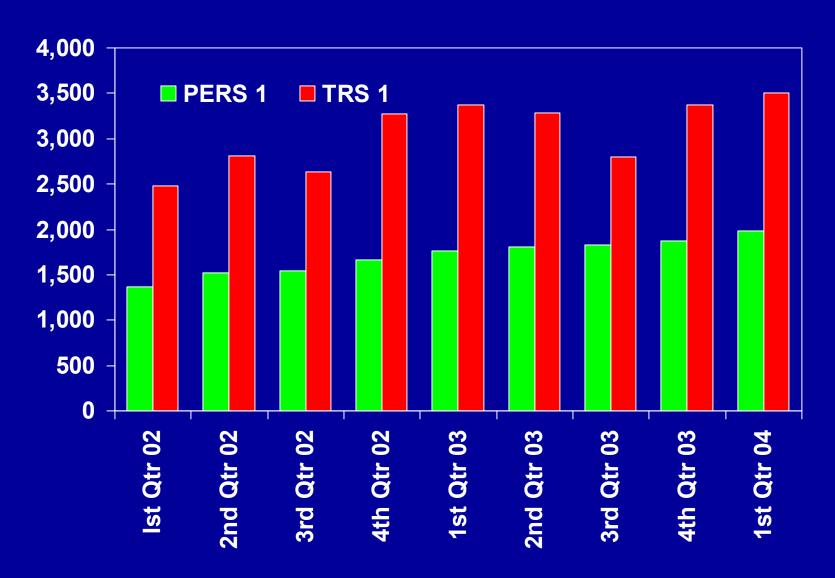
- 2001 Legislation
- 2003 Legislation
- 2004 Legislation

Fiscal Impact

 Key to cost – are members retiring earlier to take advantage of new law?

- Hard to determine why people retire
- Compare experience to assumptions
- 5-6 years of data needed

PERS 1 and TRS 1 Total Rehires by Quarter



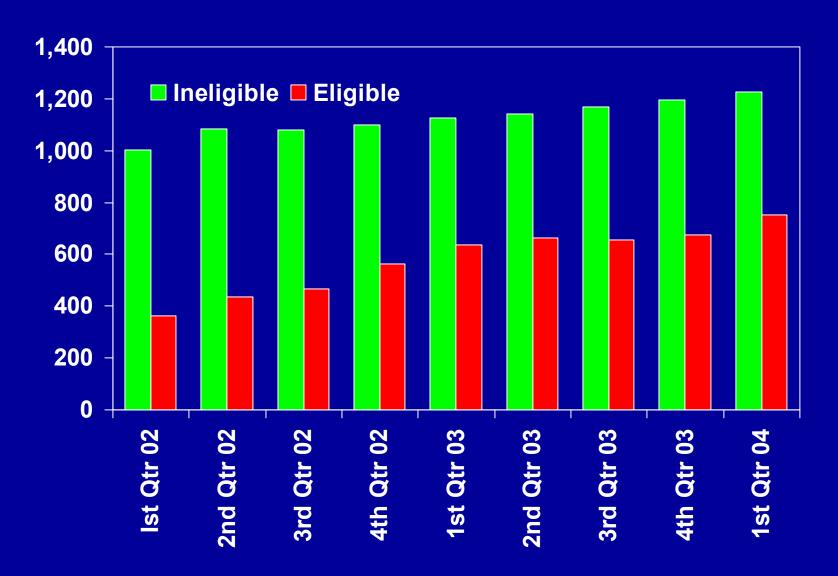
Current Trends

No significant changes since December 2003

Gradual increase in number of rehires

Higher rehire rate for TRS 1 than for PERS 1

PERS 1 Rehires by Eligibility by Quarter



TRS 1 Rehires by Eligibility by Quarter



Current Trends

- Most TRS 1 retirees return to "eligible" positions (working a full school year)
- PERS 1 retirees return to both part-time and full-time work

Plan 1 Rehires by Amount Worked

SYSTEM	2002	2003	2004*
PERS Under Prior Limit	577	598	800
PERS Over Prior Limit	337	492	0
TRS Under Prior Limit	3,006	2,997	3,137
TRS Over Prior Limit	760	1,101	626

^{*}PERS 2004 based on 3 months of calendar year data

^{*}TRS 2004 based on 7 months of school year data

Current Trends

 Of those working over prior limits, more are in TRS 1

 More retirees are rehired than before the 2001 legislation

Cost is indeterminate at this time

Philosophy of Retire/Rehire

They earned it

It's double dipping

Plan Design

- Service-based plans
- Age-based Plans

Legal Constraints

Federal tax law

- State statutory framework
- Contractual rights

Other Systems

Updated comparisons

Washington not atypical

Trends

- Aging workforce
- Baby boomers
- Change to Social Security law
- Desire for phasing

Challenges

- Short-term cycle or long-term trend?
- Constraints on changing pension structure
- Public relations

Purpose of Retirement Plan

At least two views:

1. Part of total compensation package; human resource tool.

2. To be available after employees stop working; address human resource needs via salary.

Conclusion

 Retire-rehire provisions - attract workers back into workforce after retirement (used more with service-based plans)

 Other tools focus on retaining older workers, e.g. increased benefit accruals (used more with age-based plans) Printed from king5.com Page 1 of 3



Investigators: Triple dipping at UW

09:11 AM PDT on Tuesday, May 25, 2004

By CHRIS INGALLS / KING 5 News



They are some of the highest paid administrators at the University of Washington, and they've found a way to earn even more money. In some cases, much more.

It's legal, but is it right?

Earlier this year, the KING 5 Investigators reported on public school administrators accused of double dipping, earning their pensions and a salary at the same time.

After that story aired viewers' tips led us to the University of Washington and the phenomenon that critics call "triple dipping:" collecting their pensions, a salary and accumulating new retirement benefits, too.

Keeping the expertise

U.W. researcher Steven Domonkos has been retired for two years now, but still comes to the lab almost every day.

Domonkos designs and builds sophisticated instruments to measure atmospheric conditions.

It's highly specialized field, so replacing Domonkos might have been impossible if not for a law that allowed U.W. to rehire him while he continued to earn his retirement benefit.

"I've been around here for 34 years. I know the place. I know the people," he said.

There's not much question that the University benefits from having Domonkos around. He's part time and his salary is just \$26,000 a year.

But the law that allowed him to return has been used dozens of times by some of the U.W.'s highest paid administrators.

Retirement and \$318,000 a year

Among them is Edward Lightfoot, the University's information systems director, who earns a \$100,000 annual retirement benefit.

A month after retirement in 2001, he was hired back into the same \$218,000 a year job.

Total earnings now: \$318,000 a year.

Vice Provost Steven Olswang retired in 2002, earning a \$63,000 benefit.

But he was back on the Tacoma campus in a month, making \$174,000 a year.

Total annual earnings, \$237,000.

A 'cozy relationship'

State Sen. Karen Fraser, who helped write the law as a way to address a shortage of K-12 teachers, was surprised to learn of the trend.

"It looks like a huge salary increase rather than a retirement," she said

Fraser said she never imagined that university administrators, who share the same retirement plan, could benefit.

"It looks like a cozy relationship between people who are very well paid," she said.

The KING 5 Investigators have obtained the records of 52 U.W. administrators who retired after the new law took effect in 2001 and were immediately rehired, usually into the same job.

There was no competition for their job openings until Fraser authored a law in 2003 that now requires vacancies to be advertised and retirees to sit out three months before applying for their old job.

All of the rehired administrators the KING 5 Investigators looked at were are part of an old state retirement plan. After 30 years of contributions, their benefits stop growing. Many saw the new retirement policy as the best way to keep building their nest egg.

But why does the U.W. have far more retire/rehire administrators than any other large university in the state?

Spreading the word at U.W.

A spokesman admits the university spread the word and told administrators about the new retirement law.

"If you're implying that somehow the University shouldn't have made this information available, I think I would disagree with that," said U.W. spokesman Norm Arkans.

"The advantage to the university is that people could get the benefit to which they're entitled for all their years of hard work and we could keep their expertise here," he said.

Sen. Frazier says the University violated the intent of the law by offering it to people who may have had no intention of retiring anytime soon.

"The spirit of the law was to be a tool of last resort, and they apparently said 'if you're eligible, let's do it'," she said.

KING 5 Investigators contacted most of the 52 rehired administrators. Only two agreed to talk on camera, but many made the same point. This problem wouldn't exist if the legislature wrote the law clearly in the first place.

The University of Washington says the practice does not cost taxpayers any more money because it would have to hire someone and pay them a pension benefit as well.

But that argument doesn't fly if you assume that some of these people wouldn't have retired, if the university didn't prompt them.

K through 12 retirees are limited in the number of years they can return to work and they can't earn an additional retirement benefit

But those rules don't apply at the University of Washington where administrators can join a new retirement plan and earn an additional retirement benefit at the same time they're receiving one from the state.

Fraser says that's unfair to all other state employees.

"I think because of the equities issue, the legislature will be addressing this next session," said Fraser.

THE ADMINISTRATORS

The following is a list provided by the University of Washington of those administrators who retired and were rehired within a matter of months, in most cases to the same job. Their monthly salary is also indicated:

Kenneth Anderson, \$13,333
John S. Armstrong, \$4,236
Coralie Baker, \$3,656
Edward Belcher, (separated)
Brian Boyle, \$5,000
Michael Bryant, \$11,282
Frank Davis, \$7,450

Steven Domonkos, \$2,210 Nancy Dosmann, \$4,295 Christian J. Eggen, \$9,018 Pamela Forbrush, \$3,060

Loretta Geotsch, \$4,580 Arlene K. Hamilton, \$4,321 Dannis Hasko, \$2,550 John H. Haukaas, \$3,994 Thomas Johnson, (separated) Sandra Kroupa, \$4,501

Carl Larson, \$2,237 Diane Leigh, \$4,590 Laurie B. Levy, \$6,739 Edward Lightfoot, \$18,165 Nancy L. Lin, \$2,802 Daniel Lotz, \$6,042

Augustine McCaffery, \$4,539 Colleen McKay, \$5,520

Colleen McKay, \$5,520 Judith M. McPhee, \$5,000 Mary Melanson, \$9,398 Jane Meredith, \$5,585 Linda Milgrom, \$4,246 Bruce F. Miller, \$5,267 Kou-Ying Moravan, \$7,824 Terry Nyman, \$2,550 Steven G. Olswang, \$14,490

Carl Osaki, \$3,173

Michael R. Peterson, \$5,436 Michael Pingree, \$16,115 Darcy Pollom, \$5,610

Carolyn Rasch, 4,424 (separated) Michael G. Reagan, \$3,037 Helen Remick, \$8,364 William Rogers, \$3,313 Sharrie W. Shade, \$6,440 Richard F. Simmons, \$3,415 Sharyl G. Smith, \$4,119 Daniel Stearns, \$5,021 Virginia Stimpson, \$4,842

Bruce Vik, \$6,508 John Watkins, \$4,292 Gary Whisler, separated Anita A. Whitney, \$9,834 Susan Williams, \$5,044 Lois J. Winters, \$5,484 Online at:

http://www.king5.com/localnews/investigators/stories/NW_052404IN_KINGONLY_tripledippingJK.1f45f04a0.html



Select Committee on Pension Policy

Post-Retirement Employment Report

December 2003

Fiscal and Policy Implications of:
Chapter 10, Laws of 2001, 2nd Special Session
(ESSB 5937)

(November 24, 2003)

Prepared by:

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Background:

In 2001, Washington State pension law was changed by expanding post-retirement employment opportunities for plan 1 of the Teachers' Retirement System (TRS 1) and for plan 1 of the Public Employees' Retirement System (PERS 1).

In response to a critical shortage of experienced teachers and other employees with skills that were in high demand, the limitation on the number of hours that a retiree can work in PERS 1 and TRS 1 was expanded to 1,500 per year (before suspension of the retirement benefit). The effective date of the law change was July 1, 2001.

The law also called for a study of the fiscal and policy impacts of the expanded post-retirement program.

Study Mandate: The office of the state actuary shall review the actuarial impact of the temporary expansion of the post-retirement employment limitations provided by sections 3 and 4 of this act. No later than July 1, 2003, the state actuary shall prepare a report for the joint committee on pension policy regarding the fiscal and policy impacts of this act.

The joint committee shall solicit information from the superintendent of public instruction, the department of personnel, the office of financial management, the department of retirement systems, and the health care authority regarding the program impacts of this act and shall report to the legislative fiscal committees no later than October 1, 2003, on any proposed changes or improvements to this act.

If the state actuary determines the expansion of post-retirement options under sections 3 and 4 of this act has resulted in increased costs for the state retirement funds, the joint committee report shall include a proposal for a process to charge those employers who employ retirees pursuant to an extension of sections 3 and 4 of this act for the costs incurred by the retirement funds under the extension. (Ch. 10, L of 01, 2nd sp. sess.)

Revised Study Mandate: Sections 5 and 6 of the bill that mandated this study were vetoed. As a result, the sunset date in 2004 that would have terminated the expansion of the post-retirement employment limitations was removed.

Further Program Changes in 2003: Chapter 412, Laws of 2003, made further changes to the post-retirement employment provisions. Of most significance to this study, the law placed new standards and procedures for the future employment of PERS 1 retirees. Specifically, the law created a lifetime limit on the number of hours a PERS 1 retiree may work after being rehired by a PERS eligible employer before suspension of their retirement benefit.

Joint Committee Replaced with the Select Committee on Pension Policy: Also during the 2003 Legislative Session, SHB 1204 (Chapter 295, Laws of 2003) was adopted. This law replaced the Joint Committee on Pension Policy (JCPP) with the Select Committee on Pension Policy (SCPP). The law enacting the mandate for this study was not revised to reflect the replacement of the JCPP. We have assumed that the duties and responsibilities of the original study mandate have transferred from the JCPP to the SCPP.

Proposed Reporting Process: In order to satisfy the study mandate, the Office of the State Actuary (OSA) proposed the following reporting process:

- OSA will present an initial draft of the report to the SCPP at the September 2003 committee meeting. The initial draft will contain an analysis of the fiscal impact of the act based on the data received thus far. The initial draft will also include a brief history and policy background for the subsequent policy impact discussion.
- 2. Based on the fiscal analysis and impact reported by the State Actuary, the SCPP will determine whether a proposal for a process to charge employers prospectively for any increased costs to the affected retirement systems is necessary.
- 3. At the October 2003 committee meeting, the SCPP will solicit information from the public and from the Office of the Superintendent of Public Instruction, Department of Personnel, Office of Financial Management, Department of Retirement Systems, and the Health Care Authority regarding the program impacts of this act.
- 4. Based on this input, the SCPP will prepare a final report for the legislative fiscal committees which may include any proposed changes to the act.

Fiscal Impact:

Background

According to the study mandate, the state actuary shall determine if the expansion of post-retirement employment options under this act has resulted in increased costs for the state retirement systems. If so, the SCPP shall propose a process to charge those employers who employ retirees for the costs incurred by the retirement funds due to the extension.

Data Used in Analysis: The Department of Retirement Systems (DRS) provided quarterly files of rehired PERS and TRS retirees since the effective date of the law change (July 1, 2001). Principle data elements provided by DRS included the following:

- counts of PERS and TRS retirees
- hours worked
- salary
- date retired
- date rehired; and
- occupational information (TRS only).

Annual valuation data from the Office of the State Actuary was also used in the analysis. **Note: These data have not been audited.**

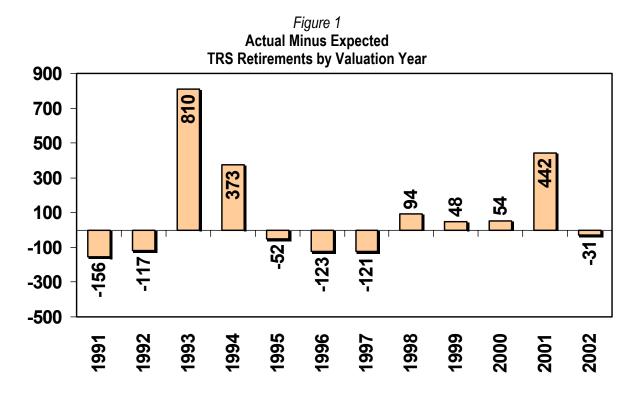
Actuarial Impact/Analysis

The extension of the number of hours a PERS 1 or TRS 1 retiree may work is not a direct benefit enhancement. In other words, it does not represent an immediate and easily measurable increase in the plan's retirement liability (like an increase in the retirement benefit formula or an increase in the plan's COLA).

Unlike a standard benefit enhancement, the actuarial impact of this program, if any, would surface through a significant increase in the number retirements over what is assumed under normal long-term plan experience. Retirements that were assumed and funded to occur at a later date, on average, would occur earlier. As a result, retirement benefits would be paid sooner than assumed and there would also be a loss of the member's contributions to the trust fund for the period of earlier retirement. PERS 1 and TRS 1 employers who employ retirees for more than the previous annual hourly limits are currently required to make employer contributions for the entire year, so there is no loss of employer contributions.

The cost of earlier retirement (i.e., longer payout) and loss of the member's future contributions outweigh the savings that result from a benefit based on a lower average final compensation and fewer years of service (from earlier retirement). Additionally, there would be limited savings of lower service in the retirement benefit from the earlier retirement of members with 30 or more years of service since the benefit formula in PERS 1 and TRS 1 is capped at 30 years of service (except for the Uniform COLA).

TRS Experience Data: The following Figure demonstrates the number of actual retirements as compared to the number of assumed retirements in TRS 1 during the 1991 through 2002 valuation plan years.



You will note a downturn in the number of actual retirements in 1991 and 1992. This may have been due to the economic downturn during the period. The large surge in actual retirements during 1993 and 1994 was due to early retirement windows enacted by the Legislature. These windows tend to suppress the number of actual retirements in subsequent years. There also appears to be a significant spike in the number of retirements during 2001 (442 more actual retirements than assumed for the period); the first year of the expanded post-retirement provisions. Care must be used in analyzing these data because of changes in valuation year end dates; 2001 captures more than 1 year of retirements, both actual and expected.

PERS Experience Data: Chapter 412, Laws of 2003, made further changes to the law. Of most significance to this study, the law placed new standards and procedures for the future employment of PERS 1 retirees. Specifically, the law created a lifetime limit on the number of hours a PERS 1 retiree may work after being rehired by a PERS eligible employer before suspension of their retirement benefit. This law change became effective on July 27, 2003.

The new lifetime hours limit will likely change the behavior of future PERS 1 retirees and current PERS 1 retirees that are currently employed in eligible PERS positions. We do not have data available on retirements since the effective date of the law change for PERS 1. As a result, there are insufficient data to determine the actuarial impact of the expanded program on PERS 1 at this time.

Normal Volatility: As noted earlier in this report, from the 2000 valuation to the 2001 valuation date, TRS 1 experienced an excess of 442 retirements over what was assumed for those eligible to retire during that period. 2001 was the first year of the expanded post-retirement employment provisions.

Actuarial assumptions are based on long-term experience periods and are not employed nor anticipated to fit actual experience exactly for an annual period. Under a reasonable set of retirement assumptions, one would expect that the total number of actual retirements would more closely resemble the expected number of retirements over longer-term experience periods (say 5 to 10 years) in aggregate.

So, with this in mind, how much of this deviation in 2001 was due to normal volatility in annual retirement experience? One simple statistical approach to this question is to review the variance and standard deviation of the annual retirement experience. In this context, these statistics measure the deviation of the extra/fewer number of annual retirements from the average number of annual extra/fewer retirements over the sample period.

This calculation is developed in the following table:

Figure 2
Standard Deviation Analysis
Actual and Expected TRS 1 Retirement Experience

			Actual	Actual *	Expected	Actual* minus Expected
7/1/1990	-	6/30/1991	903	903	1,059	-156
7/1/1991	-	6/30/1992	911	911	1,028	-117
7/1/1992	-	6/30/1993	1,893	1,083	1,083	0
7/1/1993	-	6/30/1994	1,422	1,211	1,049	162
7/1/1994	-	6/30/1995	1,051	1,288	1,103	185
7/1/1995	-	6/30/1996	1,003	1,240	1,126	114
7/1/1996	-	6/30/1997	1,028	1,265	1,149	116
7/1/1997	-	6/30/1998	1,331	1,568	1,237	331
7/1/1998	-	6/30/1999	1,359	1,434	1,311	123
7/1/1999	-	6/30/2000	1,452	1,452	1,398	54
	-	Standard D	eviation**			159
7/1/2000	-	9/30/2001	3,042		2,600	442
10/1/2001	_	9/30/2002	1,426		1,457	-31

^{*}The extra retirements in 1992 and 1993 due to the early retirement windows were evenly distributed over the subsequent five years. The 2001 and 2002 plan years were excluded from the sample. Because of changes in the valuation year end date, data for 2001 include more than 1 year for actual and expected retirements.

The 442 extra retirements during the 2001 valuation period represent the number of extra retirements from July 1, 2000 through September 30, 2001. Since most TRS 1 members retire effective July 1st, this period represents nearly two years of retirement experience (both actual and expected). The 442 extra retirements during the period is equivalent to a rate of 237 extra retirements per year over the period. This is equivalent to about 1.5 standard deviations from the mean.

Causal Relationship: There are numerous factors that influence an individual's decision to retire. Could the opportunity to work up to 1,500 hours during retirement provide an incentive for TRS 1 members to retire earlier than they otherwise would have and return to work? Yes. Could this expanded opportunity provide a stronger incentive for TRS 1 members with 30 or more years of service to retire earlier? This seems quite possible since the TRS 1 benefit formula is capped at 30 years of service. There are certainly additional factors that may provide a similar incentive. Furthermore, TRS 1 members are not guaranteed post-retirement employment in their former positions.

Unfortunately, there are insufficient data to determine the direct cause for the increase in TRS 1 retirements during 2001. Therefore, we cannot determine the true causal relationship for the increase in retirements. That being said, it does not eliminate the possibility that the increase was due, at least in part, to the expansion in the post-retirement employment provisions. Any increase in the actual number of retirements, over what is assumed, will represent an increase in the TRS 1 retirement liability if the trend were to continue in the future.

^{**}Based on a population mean value of zero.

Limited Experience Period: How much data are needed to determine if a new trend has been established? Typically, actuaries study retirement plan experience every 5 to 6 years and adjust long-term retirement assumptions based on actual retirement experience over a 5 to 6 year consecutive period for a significant-sized cohort that is eligible to retire.

Substantial changes in plan provisions, like the expansion of the post-retirement employment provisions for TRS 1, may warrant an adjustment to the plan's retirement assumptions sooner than the 5 to 6 year experience study cycle. Under such circumstances, an actuary must use their professional judgment when determining whether an adjustment is necessary and, if so, how much credibility or weight to place on any emerging deviation in plan experience. Such an adjustment would allow the plan sponsor and covered employers to pre-fund any increase in plan liability. This funding approach, however, would charge all employers, whether they employ retirees for extended periods or not.

Actuarial Cost Characteristics: The direct cause of an earlier retirement is not easy to ascertain. The cost of an extra or earlier retirement, however, is a relatively standard actuarial calculation. The dollar cost is the actual retirement liability minus the expected retirement liability (actual minus expected). The expected liability would include projected future salary and service accruals plus the probability of future retirement at each age in the future. The actual liability reflects the liability of an immediate retirement based on salary and service at the valuation date.

Figure 3 displays the cost of earlier retirement for the 527 TRS 1 members that retired and rehired for more than 840 hours per year during the study (about two years of TRS 1 retirement experience). 840 hours was the former annual limit on the number of hours before suspension of the retirement benefit in TRS 1.

Figure 3

Actual Minus Expected Liability

TRS 1 Retirees Working over the Post-retirement Employment Limits

		Over 840 Hours			
Count		527			
Present Value of Fu	ully Projected Benefits (\$ in thousal	nds)			
100% Retired	– Actual	\$218,979			
Remain Active	Expected	\$180,420			
Difference		\$ 38,559			
	Averages				
Present Value of Fully Projected Benefits					
100% Retired	– Actual	\$415,519			
Remain Active	Expected	\$342,354			
Difference		\$ 73,165			
Difference as % of Expected Salary		31%			
Annual Salary		\$ 63,319			
Service		31			
Age		55			

The average cost per person is about \$73,000. This represents a cost of about 30% of pay, per retiree, for each year of earlier retirement (about 2.5 to 3 years on average in this sample).

This analysis of the cost characteristics in this section is limited by the availability of only 15 months of experience. Further study with additional years of data will increase the confidence and significance of the analysis. The cost of an earlier retirement, however, is a relatively stable percentage of pay for each year of earlier retirement.

Conclusion – Actuarial Analysis

Based on the above analysis, the state actuary has determined that the expanded post-retirement provisions of Chapter 10, Laws of 2001, 2nd special session, has resulted in increased costs for TRS 1. The exact cost to TRS 1, however, is not easily measurable with a high degree of accuracy or confidence. These limitations do not eliminate the presence or possibility of a cost to the plan.

Due to recent changes to the original retiree law affecting PERS 1, there are insufficient data to determine the actuarial impact of the expanded program on PERS 1 at this time.

Initial actuarial analysis suggests that the expanded program has resulted in an apparent increase in the number of actual TRS 1 retirements (as compared to what is assumed and funded through the actuarial valuation). This analysis is limited by availability of only 15 months of experience data and the lack of sufficient data to determine a direct causal link in the increase in TRS 1 retirements to the expansion of the post-retirement provisions.

Preliminary costs for each additional or earlier retirement as a percentage of an individual TRS 1 member's salary for employers hiring TRS 1 retirees for more than 840 hours is approximately 30% for each year a TRS 1 member retires earlier than was assumed in the actuarial valuation (on average). Cost estimates based on group averages that are applied to individual retirees, by definition, will undercharge some employers and overcharge others. Additionally, there is no clear-cut method of determining whether a retiree, on an individual basis, is an extra retirement.

Options:

- 1. Charge individual employers an additional 6% of pay, the member contribution rate, for each year a TRS 1 employer hires a TRS 1 retiree for more than 840 hours. The additional employer charge will stop once the rehired retiree reaches age 60 (the latest normal retirement age of the plan).
- 2. Defer a proposal to charge individual employers until further data and study is available.
- 3. Do not charge individual employers, but allow the exact increase in costs to emerge in the TRS 1 unfunded actuarial accrued liability that is paid by all TRS employers.

Analysis of Options:

Option 1 would recognize a portion of the increase in cost to TRS 1. The additional 6% employer charge is well below the average 30% charge for each year of earlier retirement, but would mitigate the consequences of applying an average rate for extra or earlier retirements to an individual employer. Additionally, the reduced employer charge of 6% recognizes the limited credibility of the preliminary nature of the data and analysis.

Option 2 would not recognize the increase in cost to TRS 1 (at least, not initially). As a result, the added cost incurred between now and adoption of the final employer charge would roll into the unfunded actuarial liability in TRS 1 and the cost would be amortized at June 30, 2024 as a level percentage of future TRS payroll for all TRS employers. This approach, however, would allow for the collection of additional data and would lead to an eventual employer charge with higher credibility.

Option 3 does not satisfy the study mandate since it would not result in a charge for only the individual employers that employ TRS 1 retirees for more than 840 hours per year. This approach, however, would eliminate the difficulty of devising a method of determining whether an individual retirement for a single employer has resulted in an extra or earlier retirement.

SCPP Proposal(s) - Fiscal

In light of the cautious fiscal conclusions of the Office of the State Actuary, the Select Committee on Pension Policy chose to defer a proposal to charge individual employers who hire retirees until further data and study are available.

Policy Implications

Background

The expansion of rehire opportunities for retirees was to accommodate the human resource needs of public employers -- school districts in particular. Many districts, particularly those in high cost urban areas, had difficulty filling teacher vacancies during the most expansive point in the last business cycle. Because public employers have little flexibility in the use of salary increases to attract job applicants, it was felt that use of pension policy to provide financial incentives for the existing teacher population, particularly recent retirees, would be a reasonable substitute.

Legislative History: At their inception, Washington's public retirement plans forbade members from returning to work at an employer within the same retirement plan. Were a retired PERS member to return to work for any PERS employer, their retirement benefits would be suspended until they terminated completely.

These restrictions were applicable to PERS or TRS retirees returning to work for a PERS or TRS employer. Retirees were never under any restriction regarding private employment, working for another state, or opportunities in the Federal government.

- The 5 month Standard: In the mid-1960s, the post-retirement employment door was opened. Legislation was passed in 1965 allowing retirees to return to work in ineligible positions those requiring 5 months or less work per year.
- TRS Follows Suit: That 5-month standard in PERS -- 5/12ths of a year -- carried over to members of TRS as well. However, that 5/12ths was translated into 75 days (5/12ths of 180 days in the school year); as a result, TRS retirees were allowed to return to work for 75 days per school year in substitute positions.

Early on, the 75-day standard for TRS retirees was translated into 525 hours using an average of 7 hours per school day. This hourly measure was more accommodating for secondary school substitutes who might not teach for an entire school day.

In this last business cycle, with labor shortages being felt in most industry sectors, the 525-hour standard for retired teachers returning to work as substitutes was enhanced to 840 hours for school districts that had documented teacher shortages. TRS retirees were allowed to work up to 2/3rds of a school year as a substitute teacher or substitute principal in such a district (7 hour per day × 120 days of the school year = 840 hours). A TRS retiree returning to work as a substitute administrator was allowed to work up to 630 hours in a district where the school district board of directors adopted a resolution declaring that the services of the retiree were necessary because they could not find a replacement administrator to fill the vacancy.

2001 Legislation: While the ability of PERS and TRS retirees to return to work had been well established, legislation was passed in 2001 to address several issues. The Joint Committee on Pension Policy (JCPP) wanted to address a PERS return-to-work issue relating to how the 5-month allowance had been interpreted, and they wanted to standardize the 840 hour limit for all TRS retirees returning to work as substitutes in all school districts. The Governor's office wanted to help address the teacher shortage situation by allowing retired teachers to return to work full-time without a suspension of their retirement benefit thus receiving a full salary along with their retirement allowance (see Appendix C).

- An Hour is a Month: When the provision was passed allowing PERS retirees to return to work for 5 months, the statute was interpreted to mean that any time worked in a given month would debit that month from the 5-month allowance. For example: if a PERS retiree began work on January 1st, they would be eligible to work full time through the end of May; or if they began work on January 31st they would still only be eligible to work through the end of May. This interpretation allowed a PERS retiree to work on a full-time basis in only monthly increments.
- An Hour is an Hour. The JCPP proposed a bill that would allow PERS members to work 867 hours per year. This was a simple translation of the monthly limit into hours (5/12ths × 2080 hours per year). By amending the statute to read in hours, retirees and employers would be given greater flexibility in scheduling; instead of being limited to working full-time for 5 months, retirees would now be able to work part-time schedules for a greater part of the year.
- 2/3rds of a School Year. The JCPP also forwarded a bill to the legislature increasing the amount of time TRS members could work in post-retirement situations. Formerly, members were limited to 525 hours of work as substitute teachers, or in districts with documented shortages, 630 hours as substitute administrators, or 840 hours as substitute teachers or principals. The JCPP bill proposed standardizing the post-retirement hourly limit to 840 hours for all TRS retirees returning to work as substitutes, be they teachers, administrators, or principals.
- Coming Back Full Time: At the same time the JCPP was proposing its legislation, the Governor's office requested legislation allowing TRS retirees to return to work for up to 1,500 hours in a school year. This hourly standard would allow TRS retirees to return to work full time as teachers since no school district had standard contracts requiring more than an 8 hour work day (8 hours per day x 183).

contract days = 1,464 hours per contract year). As a result, retirees could return to work and, if they worked the entire school year, receive a full salary along with their full retirement allowance. More importantly, this legislation would also allow TRS retirees to return to work in other than substitute positions.

The 1,500 hour standard was proposed for PERS retirees as well. This would allow PERS retirees to work almost 9 months of the year without their benefit being suspended. As a result, PERS 1 retirees could return to work and, if they worked the full year, receive a full salary and three-quarters of their retirement allowance.

To help alleviate any potential cost of this change, the bill required that employers engaging a retiree for more than 867 hours, the earlier PERS standard, pay employer contributions to the retirement system for the entire time of the retiree's employment.

• Without Reference: In an unusual development, both the JCPP bill amending the post-retirement provisions in the TRS chapter (Ch. 317, L of 01, 1st sp. sess.) and Ch. 10, L of 01, 2nd sp. sess. passed into law in 2001. Since neither bill referenced the other, both were codified. With both provisions codified, legal precedent required that the more advantageous provision apply, thus the 1,500 hour limit became the standard.

The JCPP bill amending the TRS chapter contained language giving the legislature the right to amend or repeal the section assuring that no member has a contractual right to 840 hours per year of post-retirement employment. The governor's request legislation contained similar language, giving the legislature the right to amend or repeal these sections and assuring that no member has a contractual right to more than 525 hours per year of post-retirement employment in TRS or 867 hours in PERS.

Post 2001 Legislation: Numerous bills were introduced after the passage of Ch. 10, L of 01, 2nd sp. sess. that sought to add provisions that both employers and members would have to follow. These provisions attempted to:

- Forbid the hiring of a retiree if there were four or more qualified applicants for the job. (Did not pass.)
- Increase the separation period after retirement before members could return for the 1,500 hours. (Passed: Increased to 90 days in PERS.)
- Require employers to provide documentation of a shortage before being allowed to hire a retiree. (Passed: Applicable to PERS employers.)
- Require employers to keep human resource records that could be audited to assure they follow existing hiring policies. (Passed: Applicable to PERS employers.)
- Limit the total number of hours a retiree could work beyond the former annual limit. (Passed: limited PERS rehires to 1,900 hours beyond the annual 867 hour limit.)
- Forbid verbal agreements to return to work. (Passed: applicable to PERS.)

In-Service Distributions

Verbal Agreements: The old caveat says that a verbal agreement is as good as the paper its written on. Old caveats die hard. Understanding verbal agreements is important because written agreements to return to work were forbidden, verbal agreements were not. There is considerable difficulty in enforcing any regulation against verbal agreements.

What Constitutes Separation: In order to be considered fully separated from their employer, PERS and TRS members must, after the effective date of their retirement, be gone for one calendar month. The effective date of a member's retirement is the first day of the month following the month in which they retired. A PERS member whose last day of employment was June 30th would have a July 1st retirement date. If they wished, they would be eligible to return to work on August 1st.

What Constitutes Retirement: The matter of what constitutes retirement arises in the melding of the "return-to-work agreement" issue and the "separation" issue. While this may seem rather academic, it could eventually be a matter effecting state policy and federal policy as well.

All qualified retirement plans, public and private, are governed by Federal statutes. The tax status of retirement plans is based on their adherence to these regulations. The litany of chapter and sub-chapter numbers of the Internal Revenue Code are familiar though not necessarily well understood: 401(a), 401(k), 403(b), 457 and so on. But one of the fundamental regulations governing public defined benefit plans is that no "qualified" retirement plan can provide "in-service distributions;" a member cannot receive their retirement benefit while still working.

With the potential for a verbal return-to-work agreement between an upcoming retiree and their employer, such a member's actual separation may be called into question. If it were determined that such agreements negated the separation of the employee from the employer, that could potentially disqualify a retirement plan allowing such an agreement. A disqualified plan would be subject to significant tax liabilities for the employee and employer.

The IRS does allow a great deal of leeway in their dealings with public retirement plans. Most recently, that leeway has allowed plans to engage in what are called transitional policies; easing members into retirement. This plan modification, however, has little resemblance to a transitional retirement policy; it is more related to personnel policy (filling hard-to-fill positions).

At its extreme, a verbal agreement to return to work may result in questions as to whether such an employee actually separated from their employer, and whether they are retired.

Other States / Systems: How do the post-retirement employment provisions in Washington State's public retirement systems compare to other states? Compared to other states', Washington's post-retirement employment provisions appear fairly typical. The following table illustrates the provisions governing post-retirement employment from select state retirement systems – the choice based on the largest systems, neighboring states, and a number of peer states based on population (see Figure 4).

Within this comparison, only Michigan's provision prohibits a member from working after they retire. Other states allow members to work a fixed number of hours for a plan employer after they retire (Calpers, Idaho, Oregon). Others allow a member to earn a fixed amount of salary (CalStrs, New York PERS and TRS). And others allow members to work full time (Kentucky and Texas).

Figure 4
Rehire Provisions from Select State Retirement Systems

State / System	Post-Retirement Employment Provisions
CALPERS	May work a maximum of 960 hours
CALSTRS	May earn a maximum of \$24,934
Idaho PERSI	May work less than half time for public employment and less than half time contract for teachers
Kentucky PERS	May return to a different job in the same retirement system and earn an additional benefit. After age 65 (or 55 for hazardous duty employees), may return to any position and earn an additional benefit if reemployed full-time.
Kentucky TRS	May return full-time with a different employer after three month separation, or return to the same employer after a one year separation. Pay limited to 75% of last salary and employers limited to using rehires in 4% of positions.
Michigan SERS	Retirement allowance will be suspended for any month for which state wages are paid
New York PERS & TRS	May earn a maximum of \$25,000
Ohio PERS and STRS	After 2 month separation may return full time but must contribute to a separate annuity.
Oregon PERS	May work a maximum of 1,039 hours
Texas PERS	May work full time with no contributions and no added benefit.

Other Rehire Characteristics

System: While rehires are found among both PERS and TRS members, the largest number come from the TRS ranks (see Figure 5).

Figure 5 Rehires by System and Percent of Total Annuitants

	PERS	TRS
Total Rehires	2,542	5,168
Percent of Annuitants	4.1%	15.6%

Comparing rehires by their ratio to total annuitants results in an even greater incidence of rehire activity by TRS members; some 15.6% of TRS retirees returned to work in a TRS position while 4.1% of PERS retirees returned to a PERS position.

Rehire Characteristics Data: In the following section of the report these data have been arrayed into groupings of members who were:

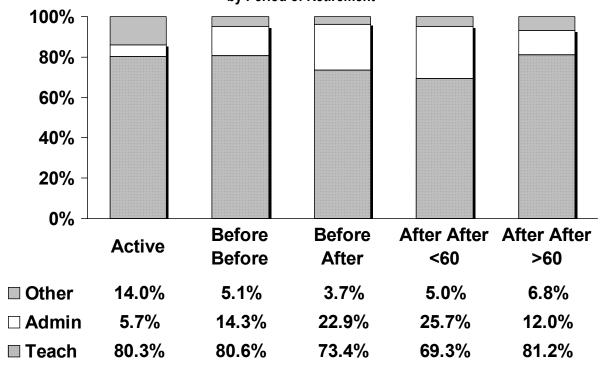
- Before Before retired and rehired before the effective date of these changes,
- Before After -- retired before and rehired after the changes,
- After After <60 -- retired after the changes and rehired within 60 days of separation, or
- After After >60 -- retired after the changes and rehired after 60 days of separation.

Plus, each of these groupings is split between those working above and below the old post-retirement hourly thresholds – 867 hours in PERS and 840 hours in TRS.

Occupations: The Department of Retirement Systems collects some rudimentary occupational information on TRS retirees but none on PERS retirees. The occupational distribution of PERS retirees can only be presumed via other measures like salary.

The occupations of TRS retirees fall within three large categories – teachers, administrators, and others (see Appendix A for detail). Two items are evident in the occupational distribution of active and rehired TRS members, the greater use of administrators in rehire situations, and the lesser use of those in "other" occupations (see Figure 6). While administrators constitute 5.7% of all TRS occupations in Washington's schools, over 25% of those rehired within 60 days of retirement have been in administrator positions. This may be called a desirability effect. These patterns hold for both PERS and TRS members. This may also be a borrowing phenomenon; those higher salaried / managerial members retiring during this period will not be included in the future averages; thus the characteristics of future retirees may exhibit a moderating age, member service, and salary profile.

Figure 6
Occupational Share of Active TRS Members and Rehired TRS Members
Working Over 840 Hours During the 2002-03 School Year
by Period of Retirement

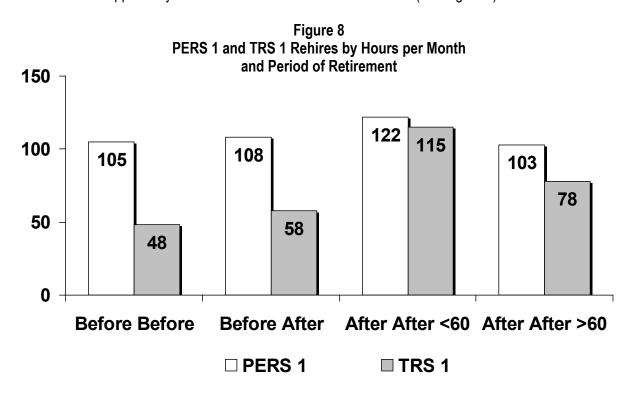


Average Final Compensation: Another measure to examine in these retire-rehire characteristics is salary; because there is no occupational identifier in PERS retirement data as there is in TRS, salary is used as a proxy. If there were a greater share of managerial retirees in the current rehire situations, that would portend a higher average final compensation (AFC). This was the case as PERS 1 retiree AFC rose significantly when comparing select rehires (see Figure 7). Even after discounting for some inflation, this may be an indication that more senior administrative and managerial members represented a greater share of recent rehires.

Figure 7 PERS 1 Rehires by AFC, Amount Working, and Period of Retirement \$6,000 \$5,853 \$5,000 \$4,809 \$4,576 \$4,346 \$4,000 \$4,259 \$3,724 \$3,496 \$3,000 \$2,000 \$1,000 \$0 **Before Before Before After** After After <60 After After >60 □ Below 867 ■ Above 867

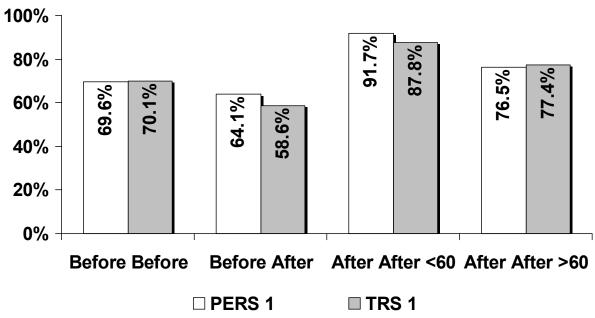
Rehire Hours: Because of the interpretation of the 5-month provision, PERS retirees who returned to work could not spread out their hours, as could TRS members. As a result, they tended to work more hours per month but for fewer months. The changes in post-retirement provisions allowed PERS 1 members to work almost twice as much as before in terms of total hours, but also gave them, and their employers, the option of working part-time for the whole year.

The greater increase in hours among the TRS members returning to work, compared to PERS, may be the result of the new opportunity to work full-time instead of as substitutes (see Figure 8).



Return to Where: When retirees return to employment, where do they return? For the most part, they return to their former employers. While a number of retirees do use retirement to change employers and seek other opportunities, they tend to be in the minority. Prior to the changes in the post-retirement statutes, approximately 2/3rds of rehires who returned to work did so with their last employer (see Figure 9). In the period immediately following the changes, nine out of ten rehires returning within 60 days returned to the same employer from which they retired.

Figure 9
PERS 1 and TRS 1 Rehires by
% at Same Employer and Period of Retirement



Who Uses Rehires: Many employers use retirees as part of their human resource policy. This analysis examines those employers who had 5 or more retirements and more than a 20% rate of rehire. Some 130 employers met that criteria, 89 TRS employers and 41 PERS employers – 18 of those PERS employers were school districts or community colleges as many of their administrative staff are not certified and are either PERS or SERS members.

As TRS members constitute the majority of rehires, it would hold that school districts be the most common employers. The largest such employer is the Seattle School District, employing 80 rehires as of the end of 2002 (see Figure 10). The top rehire employers are school districts within the Puget Sound region. That these tend to be among the largest school districts in the state is one of the reasons they employ large numbers of rehires. In addition, it is within this region where all employers experienced significant labor shortages at the peak of the last business cycle.

A number of PERS employers also employ a significant number of rehires. The Department of Social and Health Services employed 44 rehires; this number is relatively middling considering the size of DSHS, and their large number of retirees. The State Department of Transportation is the next PERS employer on the list with 23 rehires.

Lake Stevens School District is noteworthy in that all those it rehired were on pace to work full time. Lake Stevens is not the only such employer (see Appendix B): all the retirees rehired by The Department of Information Services, McNeil Island Correctional Facility, Kiona- Benton City School District, Grandview School District, and Ellensburg School District were on pace to work beyond the earlier hourly limits.

Figure 10
Rehires by Employer Ranked by Number Working Above Earlier Limit
From July 1, 2001 to December 1, 2002

Department Name	Retirees	Rehires	Over 840-867 Hour Threshold
Seattle SD	225	80	35
North Thurston SD	64	46	27
Highline SD	75	38	25
DSHS	294	44	21
Lake Washington SD	70	30	18
Renton SD	46	32	18
Northshore SD	55	33	12
Shoreline SD	50	19	12
DOT	116	23	12
Tacoma SD	129	65	11
Edmonds SD	77	32	11
Lake Stevens SD	19	11	11
Kent SD	79	28	10
Auburn SD	45	14	10
Issaquah SD	43	20	9

Unemployment Insurance Issue

Unemployment insurance (UI) is provided to those that lose their jobs. To qualify, a worker had to have been in a job covered by unemployment insurance, have worked 680 hours in 4 of the last 5 calendar quarters, and be without work through no fault of their own.

Workers who retire are not unemployed – they have voluntarily left employment and do not qualify for UI. By returning to work, however, most retirees place themselves on a new rung of the labor market ladder. The majority of retirees in public sector return-to-work arrangements are no longer in permanent jobs. They no longer have an expectation of continued employment beyond a fixed point in the future – normally less than one year. As a result, when they separate from that job, they are considered unemployed. And if they worked at least 680 hours in that job, they are eligible for UI.

State and local governments in general have a low incidence of employee lay-offs or reductions in force (RIFs). There are a variety of government employers – parks departments, and even schools – that use seasonal employees. But even these employees have a reasonable expectation of continued employment; school employees don't work in July and August, but know they have a job come September. As a result, the unemployment taxes paid by State and Local government are quite low on the tax schedule. However, by hiring a retiree who may, at the end of their employment, be eligible for UI, government employers may be increasing their unemployment tax liability. While this is not a cost to the retirement plans, it is a cost nonetheless. Recent legislation (SHB 1829, C412 L03) requires DRS and the Employment Security Department to notify employers about the possible unemployment compensation consequences of hiring retirees.

Retirees Return

It appears that retirees are attracted back to public employment by increasing the number of hours they are allowed to work before their benefit is suspended. This can be seen when comparing the counts over time of retirees who already had some post-retirement work experience, and counts of other retirees whose original retirement decision could not have been influenced by the change in statute. These two groups of retirees experienced an increase of 1,347 workers between June and December of 2002 (see Figure 11).

Figure 11
Counts of Rehires Whose Original Retirement Decision
Was Not Influenced by Ch. 10, L of 01, 2nd sp. sess.

	Before Before		Before		
Period Ending	PERS 1	TRS 1	PERS 1	TRS 1	Total
June 02	711	1,281	621	1,767	4,380
Dec 02	924	1,527	1,022	2,254	5,727
Increase	213	246	401	487	1,347

Stakeholder Input

The Select Committee on Pension Policy (SCPP) invited the Office of the Superintendent of Public Instruction, the Office of Financial Management, the Health Care Authority, the Department of Retirement Systems, and the Department of Personnel to provide input as to the program impact of the broadening of post-retirement employment hours. Their input was heard at the October and November 2003 interim hearings of the SCPP. Each provided the committee with written testimony which can be found in Appendix D.

Appendix A

Department of Retirement Systems Occupational Classification for TRS Members

Duty/Assignment*	Individuals*	DRS Classification
Superintendent	279	Administrator
Deputy/Assist. Supt.	159	Administrator
Other District Admin.	1,032	Administrator
Elementary Principal	1,171	Administrator
Elem. Vice Principal	170	Administrator
Secondary Principal	653	Administrator
Secondary Vice Principal	775	Administrator
Other School Admin.	394	Administrator
Elementary Teacher	31,548	Teacher
Secondary Teacher	26,298	Teacher
Other Teacher	7,416	Teacher
Other Support Personnel	3,340	Other
Library Media Specialist	1,457	Other
Counselor	2,231	Other
Occupational Therapist	379	Other
Social Worker	139	Other
SpchLang. Path./Audio.	1,095	Other
Psychologist	936	Other
Nurse	512	Other
Physical Therapist	152	Other
Reading Resource Spec.	20	Other
Extracurricular	1,101	Other
Substitute Teacher	52	Teacher
Certificated on Leave	497	Depends on role when active

^{*}From Washington State Superintendent of Public Instruction, School District Personnel Summary Profiles.

Appendix B

RETIREE RETURN TO WORK SUMMARY FOR DECEMBER, 2002

Percentage of Rehire by Department for Members Retiring Between JULY 2001 and DECEMBER 2002

Departments having 5 or more retirements and more than a 20% rate of rehire

		Reh	nires	Ove	limit
DEPARTMENT NAME	Retirees	Number	Percent	Number	Percent
NACHES VALLEY SD 003 JT	10	10	100.0%	8	80.0%
WHITE RIVER SD 416	9	9	100.0%	4	44.4%
PUYALLUP SD 003	57	53	93.0%	5	9.4%
UTILITIES & TRANSPORTATION COM	7	6	85.7%	0	0.0%
KIONA-BENTON CITY SD 052	6	5	83.3%	5	100.0%
DEER PARK SD 414	6	5	83.3%	0	0.0%
ENUMCLAW SD 216	15	12	80.0%	6	50.0%
KELSO SD 458	12	9	75.0%	5	55.6%
TUKWILA SD 406	8	6	75.0%	4	66.7%
ANACORTES SD 103	8	6	75.0%	2	33.3%
N THURSTON PUBLIC SCHOOLS - SD	64	46	71.9%	27	58.7%
RENTON SD 403	46	32	69.6%	18	56.3%
KETTLE FALLS SD 212	6	4	66.7%	0	0.0%
SELAH SD 119	6	4	66.7%	0	0.0%
UNIVERSITY PLACE SD 083	17	11	64.7%	7	63.6%
CAMAS SD 117	11	7	63.6%	4	57.1%
SEATTLE COMMUNITY COLLEGE	18	11	61.1%	0	0.0%
EASTMONT SD 206	18	11	61.1%	4	36.4%
NORTHSHORE SD 417	55	33	60.0%	12	36.4%
FERNDALE SD 502	20	12	60.0%	5	41.7%
LAKE STEVENS SD 004	19	11	57.9%	11	100.0%
MERCER ISLAND SD 400	21	12	57.1%	5	41.7%
YELM SD 002	14	8	57.1%	6	75.0%
GREEN RIVER COMMUNITY COLLEGE	7	4	57.1%	0	0.0%
SUNNYSIDE SD 201	7	4	57.1%	0	0.0%
SUNNYSIDE SD 201	7	4	57.1%	2	50.0%
WAPATO SD 207	7	4	57.1%	3	75.0%
BREMERTON SD 100	, 18	10	55.6%	4	40.0%
CORRECTIONS AIRWAY HTS CORR CT	9	5	55.6%	0	0.0%
THURSTON CO	9	5	55.6%	1	20.0%
SHELTON SD 309	9	5	55.6%	3	60.0%
GRANDVIEW SD 200	9	5	55.6%	5	100.0%
MOUNT VERNON SD 320	13	7	53.8%	1	14.3%
HIGHLINE SD 401	75	7 38	50.7%	25	65.8%
TACOMA SD 010	129	56 65	50.4%	25 11	16.9%
MONROE SD 103	14	7	50.4%	2	28.6%
				4	
SEDRO WOOLLEY SD 101 QUILLAYUTE SD 402	12 8	6 4	50.0%	1	66.7% 25.0%
		4	50.0%		
COLVILLE SD 115	8		50.0%	3	75.0%
STEILACOOM HISTORICAL SD 001	6	3	50.0%	2	66.7%
CLOVER PARK TECHNICAL COLLEGE	6	3	50.0%	1	33.3%
KENNEWICK SD 017	37	18	48.6%	5	27.8%
ISSAQUAH SD 411	43	20	46.5%	9	45.0%
ELLENSBURG SD 401	11	5	45.5%	5	100.0%
BURLINGTON-EDISON SD 100	11	5	45.5%	0	0.0%
PORT ANGELES SD 121	27	12	44.4%	6	50.0%
MUKILTEO SD 006	18	8	44.4%	2	25.0%
SNOQUALMIE VALLEY SD 410	16	7	43.8%	3	42.9%
STANWOOD SD 401	16	7	43.8%	5	71.4%
SEQUIM SD 323	9	4	44.4%	2	50.0%

Appendix B

Continued

		Reh	nires	Over	limit
DEPARTMENT NAME	Retirees	Number	Percent	Number	Percent
LAKE WASHINGTON SD 414	70	30	42.9%	18	60.0%
SUPERINTENDENT OF PUBLIC INSTR	14	6	42.9%	5	83.3%
TAHOMA SD 409	14	6	42.9%	2	33.3%
ROCHESTER SD 401	7	3	42.9%	0	0.0%
LYNDEN SD 504	7	3	42.9%	1	33.3%
EDMONDS SD 015	77	32	41.6%	11	34.4%
BELLINGHAM SD 501	36	15	41.7%	2	13.3%
OAK HARBOR SD 201	24	10	41.7%	1	10.0%
BAINBRIDGE ISLAND SD 303	17	7	41.2%	4	57.1%
BELLEVUE SD 405	60	24	40.0%	7	29.2%
AUDITORS OFFICE ST	10	4	40.0%	2	50.0%
TACOMA SD 010	38	15	39.5%	0	0.0%
SHORELINE SD 412	50	19	38.0%	12	63.2%
CLOVER PARK SD 400	45	17	37.8%	5	29.4%
INFORMATION SERVICES DEPT OF	13	5	38.5%	5	100.0%
CORRECTIONS MCNEIL ISLAND CORR	8	3	37.5%	3	100.0%
RENTON SD 403	8	3	37.5%	1	33.3%
MONTESANO SD 066	8	3	37.5%	0	0.0%
SEATTLE SD 001	225	80	35.6%	35	43.8%
EVERGREEN SD 114	58	21	36.2%	4	19.0%
MOSES LAKE SD 161	14	5	35.7%	2	40.0%
PENINSULA SD 401	14	5	35.7%	2	40.0%
TUMWATER SD 033	14	5	35.7%	0	0.0%
AGRICULTURE DEPT OF	11	4	36.4%	1	25.0%
KENT SD 415	79	28	35.4%	10	35.7%
CENTRAL KITSAP SD 401	23	8	34.8%	2	25.0%
VANCOUVER SD 037	62	21	33.9%	5	23.8%
MARYSVILLE SD 025	35	12	34.3%	4	33.3%
S KITSAP SD 402	24	8	33.3%	4	50.0%
CORRECTIONS WA STATE REFORMATO	18	6	33.3%	2	33.3%
WESTERN WA UNIVERSITY	15	5	33.3%	0	0.0%
LONGVIEW SD 122	12	4	33.3%	1	25.0%
YAKIMA CO	9	3	33.3%	2	66.7%
MOUNT ADAMS SD 209	9	3	33.3%	2	66.7%
BELLEVUE COMMUNITY COLLEGE	6	2	33.3%	0	0.0%
EVERETT PORT OF	6	2	33.3%	1	50.0%
OAK HARBOR SD 201	6	2	33.3%	0	0.0%
MOSES LAKE SD 161	6	2	33.3%	1	50.0%
WALLA WALLA SD 140	6	2	33.3%	0	0.0%
CASTLE ROCK SD 401	6	2	33.3%	1	50.0%
PASCO SD 001	19	6	31.6%	1	16.7%
AUBURN SD 408	45	14	31.1%	10	71.4%
LONGVIEW SD 122	32	10	31.3%	4	40.0%
SPOKANE PUBLIC SCHOOLS	91	27	29.7%	3	11.1%
ARLINGTON SD 016	10	3	30.0%	1	33.3%
BETHEL SD 403	35	10	28.6%	0	0.0%
EVERETT SD 002	35	10	28.6%	5	50.0%
CHENEY SD 360	21	6	28.6%	0	0.0%
COMMUNITY COLLEGE OF SPOKANE	14	4	28.6%	0	0.0%
RENTON CITY OF	7	2	28.6%	1	50.0%
HOQUIAM SD 028	7	2	28.6%	1	50.0%
WHITE PASS SD 303	7	2	28.6%	1	50.0%
SNOHOMISH SD 201	22	6	27.3%	0	0.0%
GRANT CO PUD 02	15	4	26.7%	2	50.0%
SHORELINE SD 412	11	3	27.3%	0	0.0%
OTHELLO SD 147	11	3	27.3%	2	66.7%
EPHRATA SD 165	11	3	27.3%	0	0.0%

Appendix B

Continued

		Reh	ires	Over	limit
DEPARTMENT NAME	Retirees	Number	Percent	Number	Percent
MOUNT BAKER SD 507	11	3	27.3%	1	33.3%
OLYMPIA SD 111	42	11	26.2%	9	81.8%
ENERGY NORTHWEST	23	6	26.1%	5	83.3%
YAKIMA SD 007	48	12	25.0%	6	50.0%
ECOLOGY DEPT OF	20	5	25.0%	2	40.0%
ATTORNEY GENERAL	16	4	25.0%	2	50.0%
CORRECTIONS WA STATE PENITENTI	16	4	25.0%	2	50.0%
ABERDEEN SD 005	16	4	25.0%	0	0.0%
EASTERN WA UNIVERSITY	8	2	25.0%	0	0.0%
ADMINISTRATIVE OFFICE OF THE C	8	2	25.0%	0	0.0%
HIGHLINE SD 401	8	2	25.0%	1	50.0%
MEDICAL LAKE SD 326	8	2	25.0%	0	0.0%
RICHLAND SD 400	25	6	24.0%	5	83.3%
SUMNER SD 320	22	5	22.7%	1	20.0%
LAKE WASHINGTON SD 414	13	3	23.1%	0	0.0%
CENTRALIA SD 401	18	4	22.2%	2	50.0%
LEWIS CO	9	2	22.2%	1	50.0%
BELLEVUE CITY OF	9	2	22.2%	1	50.0%
EVERETT CITY OF	9	2	22.2%	1	50.0%
EVERGREEN SD 114	9	2	22.2%	0	0.0%
CENTRAL KITSAP SD 401	9	2	22.2%	0	0.0%
KC METRO	70	15	21.4%	1	6.7%
PIERCE CO	14	3	21.4%	1	33.3%
TRS Employers	2,451	1,073	43.8%	428	39.9%
PERS Employers	531	172	32.4%	45	26.2%
Total	2,982	1,245	41.8%	473	38.0%

O:\SCPP 03\9-16-03 Full\Post Retirement Appendix C.xls

Appendix C

Governor's Veto Message for SHB 1829

"I am returning herewith, without my approval as to sections 1 and 2, Substitute House Bill No. 1829 entitled:

"AN ACT Relating to post-retirement employment in the public employees' retirement system and the teachers' retirement system;"

This bill would impose new standards and procedures for rehiring members of the Teachers Retirement System and the Public Employees Retirement System who have retired from public employment.

I initially proposed the retire-rehire legislation in 2001 to address the shortage of qualified teachers and school administrators. Prior to this law, the Teachers Retirement System penalized experienced teachers by limiting them to 30 years of retirement service credit, even if they taught longer than that.

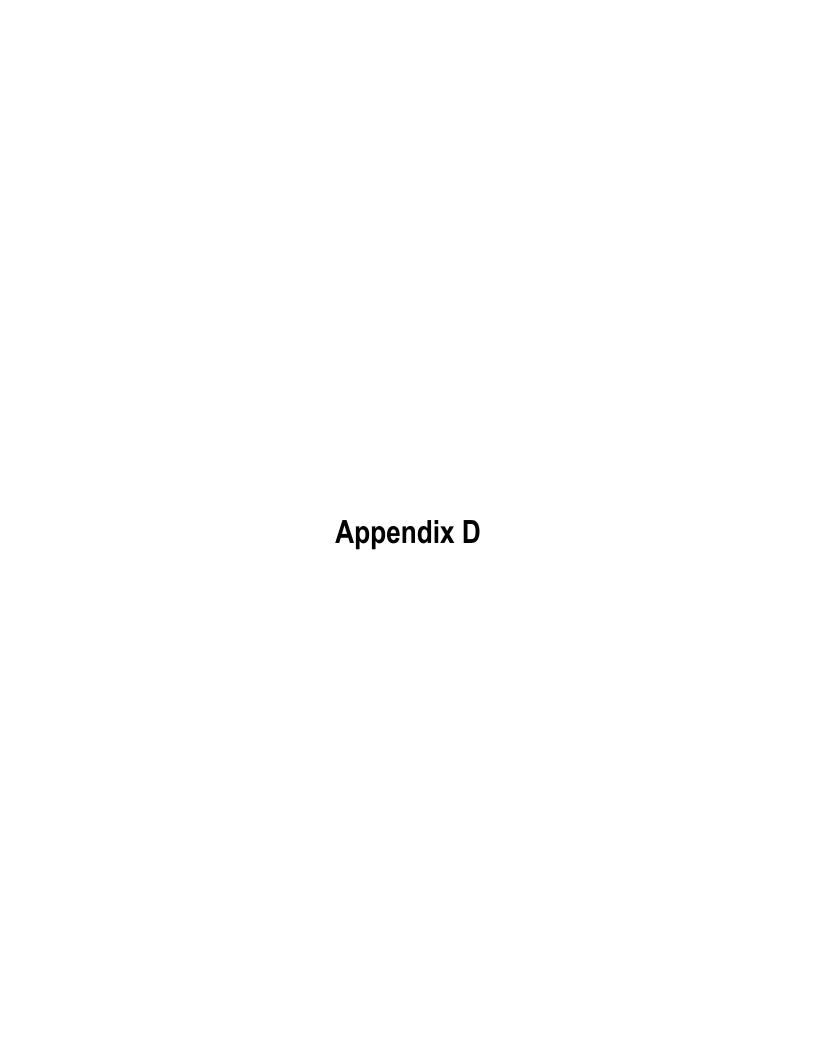
Section 1 would make it a felony for a member of the Teachers Retirement System to enter into an oral or written agreement to resume employment after retirement. While I appreciate the intent of the Legislature to prohibit employees and employers from entering into private handshake deals, the penalty in this section is significantly more severe than the penalty for similar acts committed by members of the Public Employees Retirement System. Therefore, I am vetoing section 1.

Section 2 would provide new standards and procedures for the future employment of retirees within the public school system. I strongly support those accountability provisions. However, section 2 would also place an artificial "lifetime limit" on the number of hours that a retired member of the system could work after being rehired, and would make that limit retroactive. The retroactive lifetime limit will place an unreasonable recruitment burden on school districts facing significant shortages of qualified teachers and principals. We must protect the ability of school districts to provide for the education of our children, and trust their locally elected school boards to properly administer the retire-rehire law. Therefore, I am vetoing section 2.

While I am not vetoing Section 4, which would make it a gross misdemeanor for a member of the Public Employees Retirement System to enter into an oral or written agreement to resume employment after retirement, I am concerned that the language of the section is flawed and therefore almost impossible to prosecute under. I believe the Legislature should consider legislation to perfect the language to make the elements of the crime clear and to place the language into RCW 41.40.055, which is the section dealing with pension fraud for this retirement system.

For these reasons, I have vetoed sections 1 and 2 of Substitute House Bill No. 1829.

With the exception of sections 1 and 2, Substitute House Bill No. 1829 is approved."





P.O. Box 42710 • Olympia, Washington 98504-2710 FAX 360-923-2766 • TTY 360-923-2701 • www.hca.wa.gov

October 20, 2003

TO:

Representative Steve Conway, Chair, Select Committee on Pension Policy

Senator Shirley Winsley, Vice Chair, Select Committee on Pension Policy

Members, Select Committee on Pension Policy

FROM:

Richard Onizuk A. Birector of Health Care Policy, Health Care Authority

SUBJECT:

Impacts of post-retirement employment provisions in Chapter 10, Laws

of 2001, 2nd special session, on the Public Employees Benefits Board

(PEBB) program

<u>Background</u>

During the 2001 legislative session, the Health Care Authority (HCA) submitted a fiscal note on ESSB 5937 that projected a 2003-05 biennial savings of \$294,000. This estimate was based on an assumed decrease of one-half to one percent in the number of non-Medicare retirees in the PEBB state active and non-Medicare retiree risk pool due to reemployment of K-12 school district retirees. Since most school districts purchase benefits for their active employees outside of the PEBB program, re-employment of K-12 retirees into positions where district benefits were available would result in fewer non-Medicare retirees in the PEBB risk pool. Non-Medicare retirees are in the same insurance rate pool as state and higher education active employees, so post-retirement employment of state and higher education employees re-hired by their employers was not expected to significantly impact the risk pool.

Public Employees Benefits Board rules currently provide retirees with two options upon retirement:

- 1. Enroll in a PEBB medical plan; or
- 2. Defer enrollment in PEBB plans if the retiree is covered through his own reemployment or the employment of a spouse or same-sex domestic partner.

October 20, 2003 Page 2

These options have been available for retirees who were re-employed by state or K-12 employers since 1996 and for retirees re-employed by other employers since 2001. If the retiree does not select option 1 or 2, he or she forfeits eligibility for PEBB retiree coverage.

The Health Care Authority requires retirees to complete a form indicating their enrollment or deferral. HCA also requires retirees to provide proof of continuous coverage upon application for re-enrollment.

The premium rate paid by non-Medicare retirees is subsidized by their inclusion in the same risk pool as active state and higher education employees. Since the rate is established on a younger and generally healthier risk pool, our actuaries estimate non-Medicare retirees receive an implicit subsidy of approximately \$200 per month in CY 03. This is the estimated value of the difference between what it costs a retiree to buy PEBB's benefit package and what it would cost to purchase the coverage through other insurance.

<u>Analysis</u>

PEBB non-Medicare retiree enrollment has dropped from 10,894 subscribers in June 2001 to 10,209 in June 2003. This is an enrollment reduction of approximately 6 percent. This compares to a prior annual trend of enrollment increases in non-Medicare retiree enrollment from 3,280 in 1992 to 10,894 in 2001.

Figure 2 on page 5 of the *Preliminary Post-Retirement Employment Report* shows an extra 442 TRS 1 retirements for 2001 and *figure 5* on page 13 of the report shows that most of the rehires were TRS members. The combination of this information with the PEBB retiree enrollment data suggests that a substantial portion of the decrease is related to reemployments and the passage of Chapter 10, Laws of 2001, 2nd special session. This is consistent with our fiscal analysis of ESSB 5937.

However, we cannot document with clarity the extent this decrease is related to the passage of the legislation. HCA currently does not have a mechanism for tracking the number of retiree deferrals or the types of re-employment (i.e., K-12 school district compared to private sector re-employment).

Thank you for the opportunity to present this information. If you have any questions, please contact me at (360) 923-2820 or Dennis Martin, HCA Director of Policy and Legislative Relations, at (360) 923-2831.



STATE OF WASHINGTON

DEPARTMENT OF RETIREMENT SYSTEMS

PO Box 48380 • Olympia WA 98504-8380 • (360) 664-7000 • Toll Free 1-800-547-6657

October 17, 2003

The Honorable Steve Conway, Chair The Honorable Shirley Winsley, Vice Chair Select Committee on Pension Policy Post Office Box 40914 Olympia, Washington 98504-0914

Dear Representative Conway and Senator Winsley:

Thank you for inviting the Department of Retirement Systems (DRS) to provide the Select Committee on Pension Policy (SCPP) with program implications of the post-retirement employment provisions of Chapter 10, Laws of 2001, 2nd Special Session (ESSB 5937). The adoption and implementation of the post-retirement rules beginning in 2001 had a positive administrative impact on DRS, its customers and suppliers. These positive impacts include:

- <u>Simplification and standardization of the post-retirement employment rules</u>. As outlined on pages 8 and 9 of the Office of State Actuary's (OSA) *Preliminary Post-Retirement Employment Report* to the SCPP, there have been numerous return to work rules, including separate standards for Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS) retirees. ESSB 5937 allowed for consistent application of rules across retirement systems, which resulted in improved communications to members and retirees. This also allowed for the implementation of simplified administrative rules for employers.
- Improved accuracy and timeliness of data. In order to provide timely customer service and administer the distinct benefit plans, DRS must rely on data provided by the approximately 1,300 employers who participate in the pension plans. The new rules standardized the reporting requirements for PERS and TRS, thus reducing employer reporting complexity. The standardized rules resulted in improved timeliness and accuracy of DRS' post-retirement data.
- <u>Electronic collection of data</u>. Prior to the adoption of the post-retirement provision in 2001, all retiree return to work data was collected manually from employers and was hand-keyed into DRS systems. Coordination with employers, combined with funding provided by the legislature, allowed DRS to improve the accuracy of the return to work data by automating those manual data collection processes.

Representative Conway Senator Winsley October 17, 2003 Page 2

<u>Electronic management of benefits</u>. DRS electronic benefit and disbursement systems are
managed utilizing a series of rule tables. The creation of consistent standards allowed DRS
to modify and develop new tables that could more efficiently manage the benefit processes.
These modifications, combined with the changes to electronically collect and store retiree
data, allowed DRS to automatically monitor retiree hours against the maximum postretirement limits.

The 2001 changes to post-retirement employment also required DRS to alter customer communications, systems and processes. The 2003 post-retirement changes modified these same communications and processes and created new requirements including:

- Monitoring the length of separation from service in order to qualify for separate and distinct post-retirement hourly limits.
- Monitoring of cumulative lifetime hourly limits including retroactive review of retiree hours back to 2001.
- Cessation of benefits based on separation from service and reaching specified hourly limits.
- New automated communications for retirees approaching the 867 and 1,500 hourly limits.
- New annual notification of hours applied against the cumulative 1,900 post-retirement limit.

Included with this letter is the detailed documentation of the administrative impacts outlined in summary above. I want to thank you again for providing DRS with the opportunity to present this information. Please feel free to contact me if you have any questions.

Sincerely,

John F. Charles

Director

Enclosure

cc: Matt Smith, State Actuary

Department of Retirement Systems Post-Retirement Employment Administrative Accomplishments

The adoption of the 2001 and 2003 post-retirement employment laws provided the Department of Retirement Systems (DRS) the opportunity to achieve specific administrative goals. Listed below are the specific goals, objectives and accomplishments implemented by DRS.

Goal

Increase member and retiree awareness and understanding of the post-retirement employment provisions.

Objective

Develop clear and concise publications and deliver to all DRS customers and suppliers.

Current Status

In 2001 and 2003, DRS communicated the new/revised post-retirement employment provisions to over 260,000 active members and 100,000 retirees. This was accomplished through the direct mailing of the *Retirement Outlook* newsletter to current retirees and a mailing to employers for active members. DRS also coordinated communication strategies with the Office of the Superintendent of Public Instruction (OSPI), Department of Personnel (DOP) and Health Care Authority (HCA), which resulted in consistent post-retirement employment information being available on each agency's Internet site.

In 2001, approximately 1,300 DRS employers received updated versions of the *Thinking About Working After Retirement* brochures for delivery to active members. DRS is in the process of revising this brochure to reflect the 2003 post-retirement employment changes.

All publications are available through DRS' Internet site, including an updated version of the PERS and TRS Member Handbooks. This information has been updated to reflect the most current changes.

Goal

Increase DRS' capability to maintain accurate retirement information for public employees.

Objective

Automate paper-based benefit processes in order to provide timely service to customers.

Current Status

Prior to 2001, managing post-retirement benefits was primarily a manual process for DRS. This included the collection of data from employers (see Goal #3 below), tracking of post-retirement limits, suspension of benefits and communications to retirees. In 2001, DRS modified its systems to receive, process and store retiree employment information, hours and compensation electronically. Benefit systems were modified to track the appropriate 867 or 1,500-hour limits and identify retirees exceeding these limits who required suspension of benefits. New systems were developed to automatically restart benefits again at the beginning of a new calendar year. At the same time, customized letters were developed to notify members that they are approaching the hourly limits.

Department of Retirement Systems Post-Retirement Employment Administrative Accomplishments

DRS is currently working on modifying its benefits systems to comply with the 2003 post-retirement changes. This includes modifications to identify and track hourly limits for each retiree returning to work (retiree eligible to work 867 hours or 1,500 hours), based on the length of time between retirement and reemployment (either 30 or 90 days). In addition, new systems are being developed to track hours that count toward the new cumulative 1,900-hour limit and provide an annual notification to members of the number of hours applied to the cumulative limit. This notification will assist retirees with the management of their benefit and understanding of the post-retirement provisions.

Customized letters created in 2001 will be modified so that they are electronically produced when a retiree is approaching their hourly limit. In addition, a simultaneous e-mail will be developed to notify employers.

Goal

Increase the accuracy of retiree employment data.

Objective

Implement electronic processes to collect retiree employment data from DRS employers.

Current Status

DRS relies on data provided by the approximately 1,300 employers who participate in the pension plans. Prior to the adoption of the post-retirement provision, all retiree return to work data was collected manually from employers and hand-keyed into DRS systems. Work with employer stakeholders, combined with funding provided by the legislature, allowed DRS to improve the accuracy of the return to work data by automating those manual data collection processes. Accomplishing this goal required the development and publication of new technical and procedural reporting requirements, which includes information regarding unemployment insurance impacts. The DRS Employer Handbook was also updated for distribution to employers.

Automating data received from employers provided DRS with the opportunity to enhance the reporting of retiree information to the Office of the State Actuary (OSA). In July 2001, DRS and OSA worked together to identify the data required for actuarial purposes. These requirements were included in the information communicated to DRS employers.



SUPERINTENDENT OF PUBLIC INSTRUCTION

DR. TERRY BERGESON OLD CAPITOL BUILDING • PO BOX 47200 • OLYMPIA WA 98504-7200 • http://www.k12.wa.us

October 21, 2003

The Honorable Steve Conway Chair, Select Committee on Pension Policy 2420 Bristol Court S.W., Suite 101 Olympia, WA 98504-0914

The Honorable Shirley Winsley Vice Chair, Select Committee on Pension Policy 2420 Bristol Court S.W., Suite 101 Olympia, WA 98504-0914

Dear Representative Conway and Senator Winsley,

I would like to thank you for your invitation to speak to the Select Committee on Pension Policy (SCPP) regarding the impact of the post-retirement employment provisions of state law. I apologize that I am unable to attend your meeting but wanted to share with you my views on this issue.

When the Legislature acted in 2001 to change the provisions of Washington state pension law, one of the concerns brought to the Legislature was the staff shortage(s) in several school districts. As the data included in the September 2003 State Actuary's report indicate, several school districts have been able to utilize the so called retire-rehire provisions of state law to retain veteran, experienced educators, administrators and other school staff—to the benefit of our students. Most notably, numerous school districts within the Puget Sound region, probably the highest cost region in the state, are leveraging the retire-rehire law. This is an area of the state where districts have repeatedly indicated they have difficulty finding qualified employees.

In the State Actuary's report he indicates that the 2001 provisions of the retire-rehire law have resulted in increased costs for the TRS 1 system. However, the report goes on to discuss that the exact cost to the TRS system "...is not easily measurable with a high degree of accuracy or confidence." I understand the State Actuary will prepare a final report that will include fiscal and policy recommendations regarding the impact(s) of the 2001 retire-rehire legislation.

Your committee is charged with proposing changes, if necessary, to employer contributions based upon the recommendations of the State Actuary. As the SCPP considers these recommendations, I hope you will keep in mind that the district staffing issues the retire-rehire legislation was designed to address have not abated. Thus, without the ability to rehire highly qualified veteran educators, administrators, and other school staff our districts would find themselves struggling to find the same calibre of employees for their hard to fill positions.

As you move forward with your task to examine the retire-rehire law, I encourage you to consider the findings of the State Actuary; consider the limitations of currently available data, and fully consider the benefit to our state of having our excellent veteran education professionals available to our schools.

Thank you for your consideration of my letter.

Sincerely.

tate Superintendent of Public Instruction



STATE OF WASHINGTON

GOVERNOR'S EXECUTIVE POLICY OFFICE

100 Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0666

October 21, 2003

Mr. Chairman and members of the committee, thank you for the opportunity to speak to you about the postretirement employment program. I am Chris Rose, from the Governor's Executive Policy Office.

This program, often called the 'retire-rehire' program, has given schools an additional tool to bring experienced teachers back into classrooms. It has also given agencies a way to bring employees with hard to find skills back into public service in Washington. We are glad that the Legislature took this step to increase management flexibility and to improve our state's ability to keep expertise available to our schools and to state and local governments.

There are two things that make this program so important. The first of these is that, despite a soft economy, Washington's schools and agencies need experienced staff. While some jobs attract many applicants, there are others that remain hard to fill, notably in technical or specialized areas. In these positions especially, we need and value the expertise of our more experienced workers. When they leave our workforce we lose skills and continuity.

The second important factor is that prior to the expanded retire-rehire provisions, PERS and TRS Plan 1 retirees already had the ability to retire and then accept employment in another state or even within the state in a job not covered by their pension. Making them forfeit their pension to return to work in covered employment just encouraged them to look for work elsewhere. The retire-rehire program helps discourage highly skilled retirees from searching for postretirement employment in other states or outside government service

This program gives us an opportunity to compete on a more even basis for the most skilled of our retirees.

We recommend the Committee wait for additional data to estimate the cost of the program. Particularly with the changes to the PERS 1 system made last session, it is too soon to know just what impact the program might have on pension system costs.

These changes, you remember, include a longer break between retirement and reemployment (3 months), tighter hiring requirements (chief executive officer approval, using established hiring processes, and with a documented need) and a lifetime maximum of 1900 hours of work beyond the 867 hours per year that was previously permitted. These changes seem likely to discourage those who are eligible for retirement from making a decision to retire purely based on the availability of postretirement employment in a covered position.

The program is providing a welcome managerial tool and a means to better manage our need for seasoned teachers and employees.

Thank you.





NOV 1 2 2003 STATE OF WASHINGTON DEPARTMENT OF PERSONNEL

Office of The State Actuary

521 Capitol Way South, P.O. Box 47500 • Olympia, Washington 98504-7500 • (360) 664-1960 • FAX (360) 586-4694

November 6, 2003

The Honorable Steve Conway, Chair The Honorable Shirley Winsley, Vice Chair Select Committee on Pension Policy 2420 Bristol Court SW, Suite 101 P.O. Box 40914 Olympia, Washington 98504-0914

Dear Representative Conway and Senator Winsley:

Thank you for the opportunity to comment on the Select Committee on Pension Policy's recent report on post-retirement employment provisions. It appears there was some confusion as to our agency's representation at your last meeting and we hope this letter will clarify our input.

The Department of Personnel primarily provides human resource assistance relating to classified employees in state agencies and institutions of higher education. The vast majority of those employees are in the Public Employees' Retirement System.

We are very supportive of giving state managers the flexibility to hire the right person for the right job, including the ability to hire retirees appropriately. The utilization of post-retirement employment since the mid-1960s has been an advantage to managers in meeting agency missions.

Administrative support for implementing the last several changes to the postretirement employment statutes has not represented a significant draw on our agency's resources.

If you would like any additional information or have questions, staff will be available at your November 18 meeting.

Sincerely,

Gene Matt Director

Jewl Wall

Select Committee on Pension Policy

Contribution Rate Setting

(July 2, 2004)

Issue

The Select Committee on Pension Policy (SCPP) identified "contribution rate stability" as one of the top four priorities of the SCPP at the May 2004 Orientation.

Staff

Matt Smith, State Actuary 360-753-9144

Members Impacted

A change to the rate setting process would impact members differently depending on their retirement plan. The member contribution rate for PERS and TRS Plans 1 is fixed in statute at 6%. Currently, LEOFF Plan 1 is fully funded, so no member contributions are required at this time. Prior to 2000, the LEOFF 1 member rate was fixed at 6%.

Members of PERS, TRS and SERS Plans 3 do not contribute to the defined benefit portion of Plan 3 (the employer provided life annuity). Members in these plans, therefore, would not be impacted.

Members of PERS, TRS, SERS, LEOFF Plans 2 and the WSP retirement system share in the cost of their retirement benefit with their employer. Therefore, a change to the rate setting process would impact Plan 2 and WSP members. As of September 30, 2002, there were 162,664 members in the Plans 2 and WSP combined. Of this count, 116,939 come from PERS Plan 2.

Current Situation

Provisions governing the current contribution rate setting process are codified under the Actuarial Funding Chapter - Chapter 41.45 RCW. In summary, these provisions provide for the systematic actuarial funding of the state retirement systems. Biennial actuarial valuations performed on odd-year valuation dates are the basis for contribution rate recommendations to the Pension Funding Council (PFC). Contribution rates adopted by the PFC in September of even-numbered years, referred to as "basic rates," are effective during the ensuing biennium subject to revision by the Legislature. Temporary and "supplemental rates" are charged in addition to the basic rates to fund the cost of benefit enhancements that are granted by the Legislature in between the 2year basic rate cycles.

History

The Pension Funding Reform Act, Chapter 273, Laws of 1989, established a systematic actuarial funding process for the state retirement systems. Contribution rates under the initial Funding Reform Act were scheduled to remain in place for a 6-year period. Additionally, the current funding policy was established including the goal to fully amortize the plan 1 unfunded liability by June 30, 2024. Prior to the Funding Reform Act, pension contributions were subject to a discretionary appropriation by the Legislature.

Chapter 519, Laws of 1993, changed the 6-year cycle established in 1989 to a 2-year cycle. Beginning September 30, 1994, contribution rates were scheduled for adoption in September of even-numbered years and revisited every two years thereafter.

Chapter 11, Laws of 2001, E2, codified the asset smoothing method under law. The method was changed from a 3-year method, determined by the State Actuary, to a 4-year smoothing period established under law.

Chapter 11, Laws of 2003, E1, modified the asset smoothing method - allowing up to an 8-year smoothing period depending on the magnitude of the deviation between the actual investment return and what was assumed for the period.

Chapter 93, Laws of 2004, created a new asset smoothing corridor for valuations performed after July 1, 2004. Following the effective date of the new law, the actuarial or "smoothed" value of assets must not exceed 130% nor drop below 70% of the market value of assets at the valuation date.

Actuarial Terms

The following table defines key actuarial terms that will be used throughout this report:

Term	Definition
Actuarial Cost Method	A procedure for allocating the actuarial present value of projected benefits and expenses to time periods, usually in the form of a normal cost and an actuarial accrued liability - "the funding method."
Normal Cost	Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year - "the cost of benefits in the current year under the funding method."
Entry Age Normal Cost	Normal cost calculated under the Entry Age Normal actuarial cost method. The normal cost is determined by the contribution rate which, if collected from a new member's entry date to retirement, would fully prefund their projected benefit - "long-term annual cost of the plan if all assumptions are realized (no short term gains or

Term	Definition
Amortization of Unfunded Actuarial Accrued Liability (UAAL)	The method of funding the difference between the actuarial accrued liability and the actuarial value of assets, usually determined under the funding policy - "method for paying off unfunded prior service liability."
Asset Valuation Method	A method selected by the actuary for smoothing the effects of short-term volatility in the market value of assets - "the asset smoothing technique."
Funding Policy	The plan sponsor's policy for determining the periodic contribution or cost for a plan - including the level of cost sharing between the employee and employer.

Policy Analysis

Current Funding Policy and Methods

The funding policy of the Legislature is contained in Chapter 41.45 RCW - Actuarial Funding of State Retirement Systems. RCW 41.45.010 outlines the intent to achieve four funding goals. Three of the goals listed in that section specifically pertain to the issue of rate stability and are listed below:

- to continue to fully fund the plans 2/3;
- to fully amortize the total costs of the plans 1 not later than June 30, 2024; and
- to establish predictable long-term employer contribution rates which will remain a relatively constant proportion of future state budgets.

Certain actuarial methods were selected in order to attain these funding goals. These methods are listed below:

Current Method	Description
Actuarial Cost Method	Aggregate cost method for plans 2/3.
	Modified Entry Age Normal method for plans 1.
Normal Cost	Aggregate normal cost for plans 2/3. The normal cost is shared equally between the plan 2 employee and plan 2 employer.
	The plan 2/3 employer normal cost is used for the plan 1 employer normal cost. The plan 1 employee normal cost is fixed at 6%.
Amortization of UAAL	No UAAL under aggregate cost method.
	Plan 1 UAAL must be amortized by June 30, 2024 as a level percentage of projected system payroll.
Asset Valuation Method	Up to an 8-year smoothing period depending on the magnitude of the deviation between the actual and assumed investment return for the period.
	Smoothed value of assets may not exceed 130% nor drop below 70% of the market value of assets at the valuation date - "the smoothing corridor."

The aggregate cost method was selected to satisfy the goal of fully funding the plans 2/3. By definition, the aggregate cost method does not allow for an unfunded actuarial accrued liability (UAAL) to develop. The aggregate normal cost is determined as the level percentage of projected payroll that will fund the difference between the present value of projected benefits and the actuarial value of assets at the valuation date. As a result, any difference between the assets and the projected liability, due to short-term gains or losses, assumption changes or benefit enhancements, is automatically reflected in the

annual cost of the plan and not amortized as a separate component of plan cost. In absence of an effective asset smoothing method, the aggregate cost method can produce volatile contribution rates under certain investment market cycles.

Plan 1, on the other hand, has a separate <u>employer</u> amortization of existing UAAL and the unfunded prior service cost is spread over the projected payroll of the retirement system - including payroll for projected new entrants. This method was selected in deference to the magnitude of the financial obligation to completely amortize the plan 1 UAAL by June 30, 2024. Because the plan 2/3 employer normal cost is used for plan 1 employers, all employers within a retirement system are charged the same contribution rate, regardless of the plan in which their employees hold membership (except for LEOFF). The total employer contribution rate is equal to the plan 2/3 normal cost plus the plan 1 UAAL rate.

The current asset valuation method is intended to address the volatility of contribution rates under the aggregate cost method when used in combination with the existing asset allocation policy. The longer smoothing period employed under the current method for larger annual asset gains or losses will reduce the volatility of future contributions rates once they return to their expected long-term levels.

The current "asset smoothing corridor" provides a direct relationship between the actuarial or smoothed value of assets and the underlying market value of assets. The smoothing corridor ensures that the asset valuation method will produce a reasonable actuarial value of assets, and when used in combination with the actuarial cost method, will produce contributions rates that are dependable and adequate.

Rate Stability - Experience

The current funding policies and methods are all independently reasonable. The end result, however, has produced contribution rates that have not been predictable and have not remained a relatively stable proportion of state budgets. This recent experience is partially explained by significant short-term volatility in the market and actuarial value of assets. Recent changes to the asset valuation method will improve rate stability in the future, but due to the timing of the asset method change, will not prevent significant increases in projected contribution rates. Had the current smoothing method been in place prior to the investment market run-up in the mid to late 1990's, the actuarial

value of assets would have been lower, and the actuarially required contribution rates at the time would have been higher. This would have resulted in the build-up of a temporary "asset reserve" that would have been available to offset the significant asset losses that followed. Given the magnitude of the short-term fluctuations in asset values, however, the new smoothing method would not have prevented the actuarially determined contribution rates from experiencing some degree of volatility.

The primary source of rate instability rests with the systematic use of annual actuarial valuation results under the current funding policy in absence of long-term expectations. The change from discretionary pension funding to systematic actuarial funding in 1989 increased the soundness of the actuarial funding of Washington's pension systems, but it may have produced a system which overemphasizes short-term results. Under this funding policy, the selection or legislative prescription of certain actuarial assumptions and methods, namely the increase in the interest rate assumption in 2001 from 7.5% to 8% and the former asset valuation method, may have contributed to a shorter-term focus on actuarial results.

Comparative Systems

The following table summarizes the contribution policies for Washington's comparative systems as reported in the 2001 Survey of State and Local Government Employee Retirement Systems, Public Pension Coordination Council:

Retirement System	Statutory Employer Rate?	Result of Actuarial Valuation?
1. Washington PERS	No	Yes
2. City of Seattle	No*	Yes
3. Oregon	No	Yes
4. Idaho (PERSI)	No	Yes
5. CalPERS	No	Yes
6. CalSTRS	Yes	No
7. Colorado PERA	Yes	No
8. Florida Retirement System (FRS)	No	Yes
9. Iowa (IPERS)	Yes	No
10. Minnesota (General Employees)	Yes	No

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11. Missouri (MOSERS)	No	Yes
12. Ohio (OPERS)	No	Yes

^{*} Employer matches the statutorily fixed member contribution plus an "excess contribution" if the actuarially required contribution rate for the plan exceeds the member and matching employer contribution.

The specific question in the Public Pension Coordination Council survey under contributions was: "How are <u>employer</u> contribution rates established?" Two response options were provided:

- statutorily at a specified rate; or
- result of actuarial valuation.

Most systems responded that employer contributions were established as a result of an actuarial valuation. Four systems, CalSTRS, Colorado PERA, IOWA PERS and the Minnesota Retirement System for general employees, responded that they have statutorily specified employer contribution rates.

Corridor Funding

Several public retirement systems, including the City of Dallas and the Maryland State Retirement system, have modified their funding policies to incorporate what is referred to as "corridor funding." There are two types of corridor funding:

- normal cost corridor; and
- funded ratio corridor.

Under a normal cost corridor approach, contribution rates are contained within a symmetric corridor, say 90%-110%, of the plan's normal cost. The normal cost that is expected to provide 100% funding is established as the median point within the corridor.

Under a funded ratio corridor approach, contribution rates are fixed from one period to the next as long as the plan's funded ratio remains within a specific corridor. For example, in Maryland the current employer contribution rate remains fixed provided the ratio of the plan's assets to actuarial accrued liability remains between 90% and 110%.

Federal Law

Section 412 of the Internal Revenue Code (IRC) specifies minimum funding rules for qualified private sector plans. An enrolled actuary must certify, on an annual basis, that a private-sector plan sponsor has contributed at least the minimum contribution to their pension plan in order for the plan to receive favorable tax treatment under the IRC. In summary, the minimum contribution is comprised of annual charges and credits under the actuarial cost method for the plan plus an additional funding charge for plans with funded ratios below 80% - based on market or "current liability" interest rates.

Because these rules are based, in part, on market interest rates, which tend to fluctuate from one period to the next, the federal laws governing minimum funding do not provide a good model for contribution rate stability. Government plans are exempt from these minimum funding rules.

Options

Several options were discussed at the SCPP's May 2004 orientation, including:

- minimum contribution rates;
- maximum rates of change from one period to the next; and
- statutorily fixed contribution rates.

Corridor funding is presented as an option exercised by other public retirement systems.

Analysis of Options

The appropriate option will depend on the plan sponsor's desire to balance several objectives:

- contribution rate stability;
- contribution rate adequacy; and
- the level of cost sharing between the employee and employer.

Minimum contribution rates that are adjusted upward for the cost of future benefit enhancements, funded equally by both employers and plan 2 employees, will provide adequate rates, maintain the current cost-sharing relationship in the plans 2, but would not be as stable and predictable as rates fixed in statute.

Statutorily fixed rates, on the other hand, may not provide adequate long-term funding of the promised benefits. The current level of employee and employer cost sharing in the plans 2 would be lost and the burden of funding future benefit enhancements or future unfunded liability would fall on the state.

The corridor funding approach would provide for greater rate stability, but likely at the expense of rate adequacy. A normal cost funding corridor would not fund the full actuarially required normal cost each year. A funded ratio corridor approach would also not fund the full actuarially required normal cost each year unless the plan falls outside the funded ratio corridor.

Recommendation of State Actuary

- Establish a minimum plan 2/3 normal cost rate equal to 90% of the normal cost calculated under the entry age normal cost method effective once the aggregate plan 2/3 normal cost rate exceeds the entry age normal cost rate.
 - The entry age normal cost rate would increase to reflect the cost of future benefit enhancements once effective.
 - ► The employer normal cost would equal the plan 2/3 employee normal cost.
- Do not allow the plan 1 UAAL rate, charged to employers only, to decrease until the actuarial value of assets is at least 125% of the actuarial accrued liability.
 - Would not apply beyond the current amortization date of June 30, 2024.
 - Would not apply to LEOFF plan 1 unless the plan develops an unfunded actuarial accrued liability in the future.

The entry age normal cost represents the expected long-term annual cost of the plan from a member's entry date - if all assumptions are realized - and does not recognize the impact of any unfunded past liability. The aggregate normal cost is equivalent to the entry age normal cost with short-term gains or losses, at the valuation date, amortized over the expected working lifetime of the current active population. As a result, the aggregate normal cost can drift away from the entry age normal cost depending on the magnitude of short-term actuarial gains and losses. Successive and significant annual actuarial gains will push the aggregate normal cost rate below the entry age normal cost rate; whereas successive and significant annual actuarial losses with push the aggregate normal cost rate above entry age. The substantial investment gains of the mid to late 1990's caused the aggregate normal cost rates to drop well below the entry age rates. A minimum entry age normal cost rate will provide for greater rate stability in the future and, combined with the aggregate normal cost and the new asset smoothing method, will support the objective of contribution rate adequacy and continuing to fully fund the plans 2/3.

The following table compares current and projected <u>employer</u> normal cost (NC) rates under the aggregate method with current average entry age normal cost rates. With the exception of WSP, normal cost rates under the aggregate method are projected to exceed 90% of the average entry age normal cost rate by 2009-11 for all systems listed in the table. This cross-over point is projected to occur at the start of the 2011-13 biennium for WSP.

Employer Normal Cost Rates				
System	Current Aggregate NC*	Average Entry Age NC**	Projected 09-11 Aggregate NC	
PERS 2/3	2.63%	4.45%	4.90%	
TRS 2/3	1.71%	5.44%	5.01%	
SERS 2/3	2.49%	4.72%	5.39%	
LEOFF 2	6.41%	8.37%	8.53%	
WSP	0.00%	10.51%	8.93%	

^{*} From the results of an actuarial valuation performed at 9/30/2002. Contribution rates currently charged to employers are based on the results of an actuarial valuation performed at 9/30/2001 and restated for Chapter 11, Laws of 2003, E1.

^{**} From the results of an actuarial valuation performed at 9/30/2002. Based on current mix of active participants and current plan provisions.

The balance between contribution rate stability and adequacy is a bit more complicated under the plans 1 with unfunded past liabilities. For these closed plans, it may be advisable to err on the side of rate adequacy as opposed to rate stability since these plans are rapidly approaching 100% annuitant or inactive status and are currently in a deficit funding position. The 125% funded ratio trigger should increase the likelihood that once amortized, the plan 1 unfunded actuarial accrued liability will not re-emerge. As an example, contributions to the LEOFF plan 1 UAAL stopped in 2000 when the funded ratio, the value of plan assets divided by actuarial accrued liability, reached 136%. In other words, at that time, LEOFF plan 1 had \$1.36 in actuarial assets for each dollar of accrued liability. As of September 30, 2002, the LEOFF 1 funded ratio had dropped to 119% and is projected to decline for the next several biennia.

The following two tables display projected UAAL rates and projected funded ratios for PERS 1 and TRS 1. The projections are based on actual investment performance through August 31, 2003 and 8% assumed annual investment return thereafter (current long-term actuarial assumption). Short-term investment experience will vary from the long-term actuarial assumption of 8%.

For both PERS and TRS Plans 1, the unfunded actuarial accrued liability (UAAL) is projected to re-emerge following the investment losses of 2000 through 2002. These investment losses largely offset the investment gains of the previous period. As a result, funded ratios for both PERS and TRS plans 1 are projected to decline in the short term, returning to their former levels, and then increase to 100% by the amortization date of June 30, 2024.

	PERS - Projected UAAL Rate	es s
Period	Plan 1 UAAL Rate	Funded Ratio
Current*	0.00%	92%
05-07	1.66%	85%-90%
07-09	2.26%	75%-80%
09-11	2.81%	65%-70%
11-13	3.19%	60%-65%
21-23	3.19%	100%

^{*} Chapter 11, Laws of 2003, E1, suspended payments towards the plan 1 unfunded liability.

TRS - Projected UAAL Rates				
Period	Plan 1 UAAL Rate	Funded Ratio		
Current*	0.00%	98%		
05-07	1.97%	90%-95%		
07-09	3.77%	80%-85%		
09-11	5.37%	65%-70%		
11-13	6.42%	60%-65%		
21-23	6.42%	100%		

^{*} Chapter 11, Laws of 2003, E1, suspended payments towards the plan 1 unfunded liability.

A rate ceiling or statutorily fixed rates are not recommended for either the normal cost or the plan 1 UAAL rates since it could impact the adequacy of future contribution rates. For example, it may become necessary to increase contribution rates beyond a ceiling for the cost of future benefit enhancements or if the plan experiences unforseen actuarial losses in the future.

Summary

Current funding policy outlines the intent to achieve a goal of stable and predictable contribution rates and to continue to fully fund the plans 2/3. Certain actuarial assumptions and methods were selected to achieve these goals. The current funding policies and methods are all independently reasonable. The end result, however, has produced contribution rates that have not been predictable and have not remained a relatively stable proportion of state budgets. This experience is partially explained by recent volatility in the investment markets. The primary source of rate instability rests with the systematic use of annual actuarial valuation results under the current funding policy in absence of long-term expectations.

Several options and recommendations are presented to address the issue of contribution rate stability. The appropriate option will depend on the plan sponsor's desire to balance several objectives:

- contribution rate stability;
- contribution rate adequacy; and
- the level of cost sharing between the employee and employer.

In the case of PERS and TRS plans 1, closed systems with unfunded prior service liability, the objective of contribution rate adequacy may trump the desire for complete rate stability.



Contribution Rate Setting

Matt Smith State Actuary

Select Committee on Pension Policy July 13, 2004

Issue

 SCPP identified "rate stability" as one of the top 4 priorities at the May orientation

Members Impacted

- Plan 1 member rates fixed in statue
- Plan 3 members do not contribute to their defined benefit
- Plan 2 members and WSP members would be impacted
 - 162,664 members in these plans combined
 - 116,939 from PERS 2

Current Situation

- Actuarial funding chapter
 - Chapter 41.45 RCW
- Systematic actuarial funding of the state retirement systems

History

- Pension Funding Reform Act of 1989
 - 6 year rate setting cycle
- 2 year rate setting cycle established in 1994
- Asset smoothing method set in law in 2001
- Asset smoothing method revised in 2003
- Asset smoothing corridor added in 2004

Actuarial Terms

- Actuarial cost method "the funding method"
- Normal cost "the cost of benefits in the current year"
- Entry age normal cost "long-term annual cost of the plan if all assumptions realized"
- Amortization of UAAL "method for paying off unfunded prior service liability"

Actuarial Terms (cont'd)

- Asset valuation method "the asset smoothing technique"
- Funding policy "plan sponsors policy for determining the periodic contribution or cost for a plan"

Policy Analysis

- Current funding policy and methods
- Rate stability experience
- Comparative systems
- Corridor funding
- Federal law

Current Funding Policy

- Continue to fully fund the plans 2/3
- Fully amortize the total costs of the plans 1 not later than 6/30/2024
- Establish predictable rates which will remain a relatively constant proportion of future state budgets

Current Methods

- Actuarial cost methods
 - Aggregate method for plans 2/3
 - Modified entry age for plans 1
- Normal cost
 - Aggregate for plans 2/3
 - Plan 2/3 normal cost is used for plan 1 employers
 - Plan 1 employee normal cost fixed at 6%

Current Methods (cont'd)

- Amortization of UAAL
 - No UAAL for plan 2/3
 - Plan 1 UAAL amortized by 6/30/2024
 - Employer rate = plan 2/3 normal cost plus plan 1 UAAL rate
- Asset valuation method
 - Up to 8-year smoothing period depending on size of annual gain or loss

Analysis of Methods

- Aggregate cost method
 - Satisfies goal of fully funding plans 2/3
 - Does not allow a UAAL to develop
 - Can produce volatile contribution rates without effective asset smoothing
- Amortization of plan 1 UAAL
 - Spread over projected <u>system</u> payroll including projected new entrants
 - Method selected in deference to available contributions

Analysis of Methods (cont'd)

Asset valuation method

- Addresses volatility of contribution rates under the aggregate method
- Larger the gain or loss the longer the smoothing period
- Asset smoothing corridor
 - Make sure you don't smooth too much
 - Reality check

Rate Stability - Experience

- Current policies and methods independently reasonable
- End result, however, has produced volatile contribution rates
- Why?
 - Short-term asset volatility
 - Overemphasis on short-term actuarial results
 - Interest rate change and former asset smoothing method

Comparative Systems

- See page 8 of full report
- Most establish employer contribution rates from the results of an actuarial valuation
- 4 systems have employer rates set in statute

Corridor Funding

- Two types
- Normal cost corridor
 - Rates contained within a corridor around the plan's normal cost
- Funded ratio corridor
 - Rates fixed unless plan's funded ratio falls outside corridor

Federal Law

- Section 412 of IRC
- Minimum funding rules for qualified private-sector plans
- Short-term focus
- Not a good model for rate stability
- Government plans are exempted from these rules

Options

- Minimum contribution rates
- Maximum rates of change
- Statutorily fixed contribution rates
- Corridor funding

O:\SCPP\2004\7-13-04 Full\Rate Setting

Analysis of Options

- Set appropriate balance among several objectives
 - Rate stability
 - Rate adequacy
 - Level of cost sharing

Analysis of Options (cont'd)

Minimum rates

 Adequate, but not as stable and predictable as fixed rates

Fixed rates

Stable, but may be inadequate in the future

Corridor funding

- Blend of minimum and fixed rate approaches
- Funding may drop below actuarially required levels

Recommendation

- Must address two areas
 - Normal cost under plans 2/3
 - Plan 1 UAAL in PERS and TRS

Recommendation (cont'd)

- Minimum plan 2/3 normal cost under entry age method once current rates exceed entry-age rates
 - Minimum rate increased for future benefit enhancements once effective
 - Retain employee and employer cost sharing in plans 2 and WSP

Recommendation (cont'd)

- Do not allow plan 1 UAAL rate to decrease until funded ratio is at least 125%
 - Would not apply beyond 6/30/2024
 - Would not apply to LEOFF 1 unless UAAL re-emerges

Recommendation (cont'd)

- Strikes the appropriate balance between rate stability and adequacy
 - Rate adequacy with aggregate method
 - Rate stability with entry age rate as a minimum
- Adequacy of plan 1 UAAL rate trumps rate stability
 - Non-decreasing rate will improve rate stability
 - 125% funded ratio target improves rate adequacy and benefit security